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FEDERAL

INTERSTATE COMMERCE COMMISSION: AIR MAIL DOCKET NO. 4

National Airways, Inc., Rate Review 1934-1936

Submitted December 29, 1937

Decided March 4, 1938

Upon review of air-mail rates of compensation on route No. 27 no unreasonable profit found to have been derived or to be accruing for the period June 25, 1934 to April 30, 1936.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, PORTER, AND MILLER

BY DIVISION 3:

No exceptions were filed to the tentative report of the examiner, which was served upon the Postmaster General and Boston-Maine Airways, Inc., (successor to National Airways, Inc.).

This is a proceeding under section 6(b) of the Air Mail Act of 1934, as amended, for review of the rates of compensation being paid to National Airways, Inc., holder of the contract for the transportation of air mail by airplane over air mail route No. 27, extending from Boston, Mass., in two sections, one to Bangor, Maine, 211 miles,¹ with seasonal service to Bar Harbor, Maine, 33 miles, and the other to Burlington, Vt., 191 miles, in order to determine whether any unreasonable profit was being derived or accruing therefrom.

Prior to the amendment of August 14, 1935, a similar review of the air mail rates of compensation being paid National had been instituted, based upon an audit of its books, accounts, and records for the period from the beginning of operations² to January 31, 1935. A tentative report therein was served on the carrier and the Postmaster General on July 1, 1935. The additional duties imposed by the amendment made necessary a further audit and a detailed examination of the carrier's expenditures and of the relation, if any, between it and its officers, stockholders, and employees on the one hand and its vendors and lessors on the other. Such further audit and examinations have been completed for the period from the beginning of operations to April 30, 1936, herein referred to as the audit period.³ A report of the further audit of the carrier's accounts was furnished to the Postmaster General pursuant to the direction of section 10 of the act, and a copy thereof was transmitted to the carrier.

The carrier was originally incorporated in May, 1933, under the laws of Delaware as National Capital Air Terminals, Inc., with general

1. With alternate route of 212 miles.

2. Operations on the Burlington section began on June 25, and on the Bangor section on June 26, 1934.

3. For purposes of this discussion the audit period is separated into two parts, the early period herein referred to extending from the beginning of operations, June 25, 1934 to February 28, 1935, and the later period from March 1, 1935 to April 30, 1936.

offices at Portland, Maine, but later changed its name, and transferred its principal office to Boston. It entered into a temporary contract with the Postmaster General for the carriage of air mail over its route at a rate of 29.5 cents,⁴ which contract was subsequently extended and then indefinitely continued.⁵ In its initial investigation under the act to determine the fair and reasonable rates of mail compensation for the transportation of air mail by airplane over this route, the Commission fixed a base rate of 33-1/3 cents for 24,000 miles per month,⁶ *Air Mail Compensation*, 206 I. C. C. 675, and by amendment of the act this basis became applicable as the rate of payment from March 1, 1935.

Capitalization and investment. The carrier's capitalization at the beginning of the mail operations consisted of 1,000 shares of stock without par value of which 310 shares had been issued for \$100 per share. During the audit period 50 additional shares were issued to officers in lieu of accrued salaries on basis of book value of \$43.44 per share as of October 31, 1934. The recorded consideration for all stock issued was \$33,172, or an average of \$92.14 per share. Of the outstanding stock, three of the directors, who were also officers, owned 100 shares each, and one employee 10 shares. The remaining shares were held by one other individual. No dividends were paid during the audit period, and no funded debt incurred.

The recorded investment in real property and equipment on June 30, 1934, was \$31,864 representing cost of property to the carrier with accrued depreciation of \$7,446. Current and accrued assets were \$22,891, with liabilities of \$32,945. Prepayments and other deferred debits were \$1,525. On April 30, 1936, the carrier's recorded property investment was \$31,579, with accrued depreciation of \$21,460; current and accrued assets were \$25,633,⁷ and liabilities were \$11,354. Prepayments and other deferred debits were \$7,759,⁸ and operating and insurance reserves were \$12,870.

At the beginning of operations the carrier had five trimotored 10-passenger Stinson, Model T, planes, equipped with 215 H. P. Lycoming engines, purchased second-hand for \$5,000 each. It later purchased five additional used engines. The planes were equipped with one-way radio and necessary instruments for night flying. One plane with its complement of three engines was retired from service during the audit period, leaving in use four planes and 17 engines. Six new radio receiving sets were bought, four in 1933 and two in 1934. Since January 1, 1936, the carrier has been equipping its planes and stations with two-way radio. Equipment of one plane was completed and the other three planes were being similarly equipped. Installation had been completed at Boston, Bangor, and Burlington, and was in progress at other points. The stations at Bangor, Augusta, Portland, and Concord were also being equipped with radio beacons.

Operations. The carrier commenced contract mail service with one round trip daily for mail and passengers on each section of the route. Ef-

4. Rates are stated in cents per airplane mile.

5. The contract required the carrier to furnish passenger facilities in addition to mail and express space on all schedules and to provide multi-motored equipment.

6. The rate was subject to certain provisions not here involved.

7. Material and supplies amounted to \$5,376. This account, however, was overstated by \$1,006 due to the inclusion of certain parts taken from planes and engines which were being reconditioned and which were already included in the investment account.

8. Of this amount \$633 represented salvage value of plane and \$844 of engine retired from service, and \$5,006 was for capital expenditures in connection with the installation of aircraft and airway communication equipment.

fective January 1, 1936, an additional mail and passenger round trip, daily except Sundays and holidays, between Boston and Bangor was authorized by the Postmaster General. Beginning July 1, and extending through October, 1935, a daily round-trip schedule for mail and passengers was maintained between Bangor and Bar Harbor. Exclusive passenger service was maintained between Boston and Bangor from June 30 to September 16, 1934; between Burlington and Montreal, Canada, off-line, from June 25 to October 31, 1934; and between Boston and Burlington, in connection with the through trip to Montreal, from June 25 to September 16, 1934. All regular service after October 31, 1934, was on-line, and all schedules were for mail, passengers, and express.

National conducted its passenger operations in the name of the Boston-Maine Airways on the Bangor section and of the Central Vermont Airways on the Burlington section under contracts by which these companies leased for a fixed rental per airplane mile for the transportation of such persons and property, including express, as the lessees might desire, the entire capacity of National's planes, except space required for the mail. The Boston-Maine Airways was controlled jointly by the Boston & Maine and Maine Central Railroads, each of which owned 50 per cent of the stock, and the Central Vermont Airways was a wholly-controlled subsidiary of the Central Vermont Railway. During the audit period the provisions of these contracts were substantially similar except as to the stipulated rental. All expenses of operation of the air service were borne by National but the railroad subsidiaries paid one-half the cost of local telephone service and traffic forms, and National was permitted the use of railroad communication wires without charge. Other expenses connected with the sale of transportation, including advertising, agents' commissions, and similar items were borne by the railroad subsidiaries. The rental paid prior to March 1, 1935, varied, but thereafter and up to January 1, 1936, was 15.25 cents for mail-passenger service. When the additional mail schedule was authorized, payment was reduced to a rate of 13-1/3 cents.⁹ Compensation for special flights or flights in second-section planes was on basis of the rate for exclusive-passenger service.

The total on-line mileage flown in the early period was 236,294 and in the succeeding 14 months to the end of the audit period, 360,693, of which mail service constituted 168,764 miles in the early period and 346,225 subsequent thereto. Exclusive on-line passenger service represented 61,637 miles flown in the early period. Ferry service constituted the remaining mileage. Pound-miles of mail were 1,906,458 and 4,099,226, respectively, with a monthly average number of pounds of 1,919.76 and 2,337.14.

Passenger traffic was seasonal. Except for March, 1936, when unusual conditions prevailed due to floods in New England, the highest revenue load

9. Under the contracts of March 1, 1935, subsequently extended, the lessees agreed to pay National "as compensation for actually completed flights on regular or delayed schedule" 32.5 cents per airplane mile for exclusive-passenger service and 32.5 cents per airplane mile for mail-passenger service, less one-half of such amount as was received for the mails, but not in excess of 15.25 cents per airplane mile, subject to the further provision that in the event scheduled air-mileage flown by National should in the aggregate exceed 1,100 miles per day the base rate should be decreased to 30 cents per plane mile for the period during which such mileage was flown. The mileage flown subsequent to January 1, 1936, did not exceed 1,100 miles per day, although compensation was computed on the base rate of 30 cents. Payments were approximately \$2,000 less than they would have been under the written terms of the contract.

factors¹⁰ were experienced in July, August, and September, 1935, when they constituted 38.78, 44.98, and 33.61 per cent, respectively. Under the agreement with the railroad subsidiaries passenger space was paid for regardless of use. Revenue passengers carried were 4,514 in the early portion of the audit period and 7,477 subsequent thereto, representing, respectively, 641,615 and 1,006,570 passenger-miles and a monthly average of 550.49 and 534.07 passengers. Passenger fares ranged from 5.90 to 14.71 cents per mile, with 10 per cent reduction for round-trip fares and special winter round-trip fares approximately 25 per cent lower than the regular fare.

Revenues and expenses. Revenues and expenses for on-line and off-line operations during the brief period when both services were maintained were not separately recorded in National Airways' accounts. For the purpose of reporting to the Postmaster General, revenues were apportioned on basis of revenue airplane miles flown in each service while expenses were distributed on basis of the total airplane miles flown in each service. Upon this basis the off-line operations resulted in a loss of \$1,625.

Total on-line revenues in the early period were \$95,024, of which \$49,225, or 51.80 per cent, was from mail, while revenues from the railroad subsidiaries under the lease amounted to \$43,365, or 45.64 per cent. Other revenues consisted of receipts from repair service and sale of fuel, amounting to \$2,101, and \$334 from special flights. On-line revenues in the later period totaled \$172,197. This amount does not include \$3,439 recorded by the carrier in its profit and loss account, which represents adjustment of mail pay between March 1 and June 30, 1935, to the basis fixed by the Commission in *Air-Mail Compensation, supra*. The mail revenue, including the retroactive payments, was \$112,235, or 63.90 per cent of the total; \$51,957, or 29.58 per cent, was received from the railroad subsidiaries; and \$10,580, or 6.02 per cent, from repair service, sale of fuel and rents of buildings and other property. Receipts from special flights were \$863. Revenues from the railroad subsidiaries in the two periods produced average returns per revenue passenger mile of 6.76 and 5.16 cents, respectively.

In the period between July 1, 1934 and February 28, 1935, the railroad subsidiaries received from the sale of airplane transportation an aggregate of \$38,219, of which \$36,710 was from passengers, \$574 from excess baggage, \$385 from express and \$550 from charter flights. The amount paid National Airways was \$9,275 in excess of the total receipts. In addition, the railroad subsidiaries bore other expenses customarily paid by air-transport companies totaling \$8,795. Between March 1, 1935 and April 30, 1936, revenues of the railroad subsidiaries amounted to \$56,876 consisting of receipts from passengers \$55,341, baggage \$315, express \$835 and charter flights and miscellaneous \$386. Revenues of the railroad subsidiaries exceeded the rental paid National Airways by \$4,550. However, their total expenses exceeded their revenues by \$9,536, representing a net loss. Passenger revenues of the railroad subsidiaries were equivalent to 5.72 cents per revenue passenger mile in the early period and 5.50 cents subsequent thereto.

Operating expenses for on-line operations totaled \$99,708 in the early period, of which amount \$29,470 was for maintenance; \$53,179, conducting transportation; \$16,066, general and administrative, and \$993 was incurred in connection with the miscellaneous operations covering the sale of fuel,

10. Ratio of revenue passenger miles to seat miles.

repair service, special flights, etc. The net income from on-line operations in this period after deducting taxes assignable thereto was a deficit of \$4,696. Nonoperating income and deductions therefrom increase the deficit to \$5,115. There is included in operating expenses an item of \$2,000, which was part of \$4,828 for officers' salaries which were voluntarily relinquished by them. Operating expenses were credited with \$2,828, but credit was not made for the \$2,000 which was recorded in the profit and loss account. Correction of operating expenses to eliminate the amount of salaries relinquished would reduce the operating deficit to \$2,696.

In the later period the on-line operating expenses aggregated \$168,160, consisting of maintenance, \$42,389; conducting transportation, \$89,839; general and administrative, \$29,882, and expense of miscellaneous operations in the sale of fuel, repair service, special flights, etc., \$6,050. Income from operations after deducting taxes assignable thereto was \$7,299 and net income after accounting for nonoperating items was \$7,440.

It has been the carrier's practice to create a reserve to cover the estimated cost of repairs to planes, engines, and communication equipment, including a servicing charge, by means of accruals currently charged to operating expenses, and to debit the reserve with actual repairs as incurred. At the close of the fiscal year, June 30, 1935, the reserve balance of \$7,337 was duly credited to operating expenses, but a balance of \$5,155 on April 30, 1936, had not yet been adjusted. Recorded expenses in each period are excessive to the extent that they include charges for repairs over and above the amount actually incurred. After adjusting the overaccrual of the reserve and making such other adjustments as have been shown herein to be proper, the carrier's net income from on-line operations in the early period would be \$2,565 and in the later period \$7,193. Included in the net income for each period are the net receipts from special flights, incidental services, etc., amounting to \$1,442 and \$5,393, respectively.

The carrier provided reserves for depreciation of its planes and engines through a monthly charge of 2.5 cents per airplane mile flown, apportioned 1.25 cents each for planes and engines. Prior to October, 1934, arbitrary amounts were charged. For the early period depreciation charges on the planes and engines amounted to \$6,037 and subsequent thereto, \$9,057. The planes were built in the summer of 1930 and had been in service prior to their acquisition. Under the present rate applied to the depreciated net book value the service life of the planes would extend approximately 7 months, and of the engines 14 months, from the end of the audit period. The radio receiving sets purchased in 1933 and 1934 were fully depreciated as of February 28, 1935, at which time two sets had been in service approximately 19 months, and three others 17, 9, and 6 months, respectively. No depreciation charges on this equipment have been entered since that date although it was used until 1936 when replacements were made. Other depreciable property consisted of shop and fuel equipment depreciated on basis of service life of 5 years, motorized equipment on basis of 2 years, and furniture and fixtures 10 years.

A reserve to cover the possible loss of planes by accident is created through a monthly charge based on 1.25 cents per mile flown. On February 28, 1935, the reserve was approximately \$2,954, and on April 30, 1936, \$7,714. In addition to the foregoing reserve, National Airways carried insurance for public and passenger liability, property damage, workmen's compensa-

tion, employer's liability, and fire loss. The amounts charged for the respective periods were \$4,843 and \$6,831, of which \$3,976 and \$5,895 were incurred in the conduct of transportation.

Cost of fuel and oil in on-line operations amounted to \$15,668 and \$22,447 in the respective periods, representing 29.46 and 24.99 per cent of the total cost of conducting transportation. These supplies were purchased under contract at a price in the later period which, after deducting the discount and State taxes refundable,¹¹ approximated 14 cents per gallon for the gasoline and 40 cents per gallon plus 4 cents Federal tax for the oil.¹² In the early period the cost was slightly higher.

National leased its hangars, airport facilities, post office space, use of landing fields, etc. The annual rental paid approximated \$8,000, the largest item of which was \$5,790 for facilities at East Boston, Mass., covering hangar, use of airport, flying field, runways, etc. Part of this space was subleased to others, thereby reducing the annual rental to about \$5,500 net.

The greatest portion of the expense for conducting transportation was incurred for wages and salaries which amounted to 45.27 per cent of the total in the early period and 49.82 per cent subsequent thereto. Flying personnel consisted of four regularly employed pilots and one relief pilot who, since January 1, 1935, were paid on basis of the National Labor Board scale. The average monthly salary of maintenance department employees was \$136.56 and of airport employees, chiefly dispatchers, \$93.92. It was the carrier's practice to pay a bonus to its employees at the end of the year usually upon basis of 10 per cent of the annual compensation.

National at the beginning of operations had four general officers and one general office employee on its pay roll, but the salary of one vice-president was discontinued on November 1, 1934. The carrier in the early period of its operation was not able to meet in full the salaries of its general officers and, as previously shown, amounts due them in the sum of \$4,828 were voluntarily relinquished and stock was accepted in lieu of \$2,172. General and administrative expenses amounted to \$14,066 in the early period and \$29,882 thereafter, of which amounts \$11,602 and \$26,597, respectively, represent salaries and expenses of the general officers.

Losses from nonmail schedules. The on-line nonmail schedules maintained by National during the early period of its operations were discontinued on September 17, 1934, and since that date only mail-passenger schedules have been maintained. National received from the railroad subsidiaries approximately 26 cents per mile as compensation for these nonmail schedules. Comparison of the cost of operations with costs at other times does not indicate that operating expenses were increased to an extent greater than the amount of direct aircraft operating expense occasioned thereby. Such expense at the time was approximately 23 cents per mile. It follows that gross receipts from such schedules exceeded the additional operating expenses incurred thereby, and that no losses resulted.

Interlocking relations. Investigation shows that none of the carrier's stockholders, officers, or employees owned or held, either for himself or for the account of any other person, any stock or other interest in any of the carrier's vendors or lessors; nor were any purchases made or rentals

11. Taxes refundable were in Massachusetts and Maine 3 cents; in New Hampshire 4 cents. The 4-cent tax in Vermont was not refundable.

12. Emergency purchases of gasoline at higher costs represented less than 5 per cent of the total quantity purchased.

paid from which its employees, officers, or stockholders appear to have benefited, either directly or indirectly.

Expenditures. In addition to the expenditures heretofore discussed, the carrier spent amounts approximately \$24,000 for various services by others such as telephone and telegraph, light, heat and power, removing snow, etc. Small amounts were spent for travel and subsistence and for legal services. Examination of the purchases made by the carrier for supplies indicates that it generally availed itself of all discounts obtainable. The five planes, equipped with engines which it purchased second-hand for \$5,000 each, had a list price new of \$23,900 each. The engines, which were acquired at an average price of \$383, had a list price new of \$3,750 with 25 per cent discount to airlines. Rates paid for insurance were \$0.0018 per airplane mile for public liability and property damage, and \$0.003 per passenger mile for passenger liability, of which respective amounts the railroad subsidiaries bore \$0.0003 and \$0.0025 per airplane mile. The annual premium for aircraft hull insurance in the amount of \$15,000 was \$604.

Conclusion. It is apparent from the direction of the statute that in reviewing the rates of compensation to determine whether an unreasonable profit is resulting therefrom, the item which must be considered is the net income from operations, rather than net income. *Inter-Island Airways, Ltd., Rate Review 1936*, 225 I. C. C. 115. National's operations for the full audit period, giving effect to the adjustments heretofore pointed out, result in a net income from on-line operations of \$9,758, of which \$2,565 was earned in the early period when the contract rates were effective and \$7,193 when the rates fixed by the Commission applied. Net income from operations include net receipts from the sale of fuel, repair service, and special flights, amounting to \$1,442 and \$5,393 for the respective periods. These services were independent of, and unrelated to, the service required by the contract with the Postmaster General and may properly be eliminated from consideration in determining whether an unreasonable profit resulted from the rates of mail compensation and the service connected therewith. If the rate fixed for mail compensation be reasonable, a carrier should not be penalized through its reduction merely because of profits not attributable to mail operations. *Inter-Island Airways, Ltd., Rate Review 1936, supra*. Net income from operations, including exclusive passenger service but excluding the incidental services heretofore described, was \$1,123 in the early period. While the exclusive-passenger operations show a small profit over and above the direct aircraft operating expenses incurred therein, such service would result in a deficit if it were charged with a proportion of all operating expenses. Many items embraced in total expenses, however, were not affected by the maintenance of the exclusive passenger schedules. In the subsequent period, when no exclusive passenger service was operated, the carrier's net income from operations connected with the mail service was \$1,800.

National's flying equipment was purchased at a low price. The net book value of real property and equipment on April 30, 1936, was \$10,118.59, which was probably less than its actual value. An additional \$5,006, recorded as deferred debits, represents capital expenditures for equipment. The carrier has also been able to date to function without any investment in airport facilities, such as offices, hangars, runways, landing fields, etc., all of which are rented. Negotiations were authorized by the carrier's directors

in April, 1936, looking to replacement of its flying units, which has since been accomplished and will result in a higher recorded investment. Allowance must also be given to the carrier's need for a reasonable amount of working capital.¹³

We find that no unreasonable profit was derived or accruing to National Airways, Inc., from the rate of compensation being paid for the transportation of air mail by airplane on route No. 27 for the period June 25, 1934 to April 30, 1936.

By the Commission, Division 3.

W. P. BARTEL,
Secretary.

(SEAL)

INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 19

Postal Revenue Limitation on Air-Mail Rates

Submitted April 29, 1938

Decided June 2, 1938

Method of, and periods for, ascertainment of "anticipated postal revenue" from air mail, and relation of such revenue to aggregate cost of transportation of air mail by airplane for fiscal year ending June 30, 1939, determined.

Karl A. Crowley, Paul D. Page, Jr., and William C. O'Brien, for the Postmaster General.

Paul M. Godehn, Luther M. Walter, Gerald B. Brophy, William I. Denning, Pruitt & Grealis by Hamilton O. Hale, A. Culbert, Francis D. Butler, H. Thomas Austern, J. Harvey Covington, and Howard C. Westwood, for various air mail carriers.

Edward G. Hamilton, for Air Line Pilots Association.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, MAHAFFIE, AND MILLER

BY DIVISION 3:

Exceptions were filed by the Postmaster General to the report proposed by the examiner and a reply was filed by the carriers.

By order of October 23, 1936, division 3 instituted on its own motion an investigation relating to that portion of section 6(e) of the Air Mail Act, as amended, which directs that the Commission, in fixing fair and reasonable rates of compensation under section 6(a) of the act,

* * * shall fix and establish rates for each route which, in connection with the rates fixed by it for all other routes, shall be designed to keep the aggregate cost of the transportation of air mail on and after July 1, 1938, within the limits of the anticipated postal revenue therefrom.

13. On April 30, 1936, cash on hand was \$577; materials and supplies, \$5,376, and special deposits representing bond deposited with the Postmaster General, \$4,948.

The proceeding was instituted with a view to the entry of an order or orders fixing and determining the method or methods to be used for ascertaining the anticipated postal revenue from domestic air mail, the period or periods for which such ascertainment should be made, and the postal revenue from domestic air mail which may be anticipated by the application of such method or methods for such period or periods beginning July 1, 1938.

All air carriers engaged in the transportation of domestic air mail were made respondents to the proceeding and the Postmaster General was notified thereof. A hearing was held in December, 1936. A study of the record then made disclosed that there had not been sufficient experience in operation under the present air mail contracts to permit of the best compliance with this direction of section 6(e), and the proceeding was accordingly reopened for further hearing in February, 1938.

Method for ascertainment of revenue. The evidence concerning a method or methods for ascertaining the anticipated postal revenue centers largely upon the cost ascertainment system used by the Postmaster General for determining the revenues and costs of the various classes of postal service. Much of the carriers' evidence is directed to a criticism of the application of this system for the purpose of section 6(e).

The cost ascertainment system was established, after exhaustive investigation and study, under the authority of the act of February 28, 1925, and cost ascertainment reports have been issued for each fiscal year beginning with the fiscal year 1926.¹ Under this system the portion of total revenues and total expenses of the postal service assignable to individual classes of service are ascertained through an elaborate system of field tests and computations. As stated on page 2 of the report for the fiscal year 1937:

No separate accounting was made, or could be made, that would assign directly the amount of revenue from these general sources produced by each class of mail, and the segregation to classes has therefore been accomplished by processes of ratio and proportion based upon tests and counts conducted at representative post offices for periods selected to cover a monthly cycle of postal business and to reflect seasonal variations.

Allocations between the several classes of mail of the amounts assignable to all mail matter are based upon ratios developed through certain physical counts. Out of a total of 45,233 domestic post offices in the fiscal year 1937, for example, 296, representing 45.64 per cent of the total postal revenues, were selected for the counts. Such counts were made during four selected "normal" periods, each of one week's duration. During that year the periods selected were September 21 to 27, 1936, November 30 to December 6, 1936, March 8 to 14, 1937, and June 14 to 20, 1937, both dates inclusive in each instance. In each of these periods the number of pieces of mail of each class originating at each of the 296 offices, and the amount of postage revenue thereon, were counted, and during the September period the total weight of the pieces in each class also was taken.

All post offices are divided into nine groups for the purpose of the cost

1. All fiscal years mentioned in this report end on June 30th of the year named.

ascertainment reports. The first group consists of the 15 largest post offices in the United States. The next five groups embrace the remaining Class I offices, and the last three groups cover second, third, and fourth class offices. First-class offices are those with total annual receipts of \$40,000 or over. The 296 offices designated for count are selected from each of the nine groups, although there appears to be no fixed relation between the number of offices thus selected and the total number of offices in each group. The ratios developed through the counts at the offices in each group are applied to the total revenue from all offices in that group, and, from the revenue from each class of mail thus ascertained, ratios of revenue of each class to total revenues are developed.

The ratios thus derived for the fiscal year 1937, the latest year for which total figures are available, show that domestic air mail represented 1.911 per cent of the "net related revenue from ordinary postage" amounting to \$650,939,021 shown in table 1 of the appendix to the cost ascertainment report.

When the cost ascertainment system was inaugurated no separate ratio for domestic air mail was developed, and it was not until 1929 that air mail was first segregated from domestic first-class mail for cost ascertainment purposes. The carriers contend that the method of such segregation has failed to give full credit to air mail for the revenues derived therefrom. While conceding that the selection of offices and periods for the cost ascertainment count may be proper for determination of relation between different classes of mail generally, they urge that the system is essentially a sampling method and is therefore entirely inadequate for accurate ascertainment of the revenue from so specialized and relatively so small a class as domestic air mail. They further urge that the volume of air mail is affected by many factors that do not apply to the other classes, and that the selection of offices for the purposes of the cost ascertainment system as a whole necessarily is not influenced by, and does not reflect, these factors peculiar to air mail. Of the 296 offices selected for count only 45 are air mail stops, whereas the total number of offices with air mail fields on December 31, 1937, was 211, of which 12 were second-class and all others were first-class offices. The total number of first and second-class offices on that date was 4,522, of which 168 were designated cost ascertainment offices.

The carriers further point out that mail to or from foreign countries bearing air-mail postage, as well as air mail to or from the possessions and Territories of the United States are not included in the count of domestic air mail, notwithstanding the fact that a considerable volume of such mail is transported between points in the United States by the domestic air-mail carriers over their routes. The Postmaster General's contention that no revenue is received from such mail is unsupported on the record. The carriers, on the other hand, contend that revenue therefrom is in fact received. Revenue from air mail transported on route No. 33 in the Hawaiian Islands also is not included in the count.²

Period for ascertainment. No evidence bearing directly upon the period for ascertainment was introduced. All of the evidence, however, was pre-

2. The expense of operating the domestic route in the Islands, however, is included in the cost of transportation of air mail shown in the exhibits of the Postmaster General.

sented with relation to fiscal years beginning July 1st. The appropriations for payment of the cost of air-mail transportation are made by fiscal years, and the act itself requires that the limitation here considered be made effective at the beginning of a fiscal year.

Ascertainment of revenue for fiscal year 1939. Although the Postmaster General contends that the cost ascertainment figures are a true index of the amount of revenue accruing from air mail, he recognizes that they are the product of computations based upon past performance, and are not alone sufficient for the purposes of section 6(e). His witnesses point out, however, that the figures are used as a basis of various estimates of the future and urge that they should be so used here. On the assumption, based upon a cost ascertainment count made during the first two quarterly periods, that the volume of air mail during the fiscal year 1938 would be about 10-1/3 per cent greater than that during the preceding fiscal year, and that the volume during the fiscal year 1939 would reflect a further increase of about 7.5 per cent over 1938, the revenue from air mail for those two fiscal years is estimated at \$13,725,000 and \$14,750,000, respectively. Not only do the carriers question the sufficiency of the amounts so estimated, but one witness for the Postmaster General expressed the opinion that the increase in the volume of air mail would be much greater under present conditions than the foregoing percentages would indicate, and that the increases would be still greater if authority is given for the establishment of new routes and service or for further advertising which the carriers point out in their reply brief have since been authorized.

The 1938 figures were based upon regular cost ascertainment data obtained during September and December, 1937, from the 62 group A and group B reporting offices, which represent slightly more than 73.5 per cent of the total estimated domestic air-mail revenue for that fiscal year.

The estimated percentages of growth during the fiscal years 1938 and 1939 are materially less than the actual growth of 15 per cent, 47 per cent, and 28 per cent, respectively, during the fiscal years 1935, 1936, and 1937. Moreover, the first estimates prepared for departmental purposes relating to the fiscal years 1936 and 1937 were 45 per cent and 67.5 per cent, respectively, less than the revenues for those years finally developed through the cost ascertainment system.

Using the pound-miles of service performed, rather than the pounds of mail dispatched, the increase during the fiscal year 1938 was estimated by the Superintendent of Air Mail at about 11 per cent, and that during the fiscal year 1939 at a further increase of about 30 per cent, unless curtailment of service became necessary for some reason. Since the fiscal year 1935 the annual postage revenues as determined through the cost ascertainment system have been approximately 1 mill per pound mile. That ratio applied to the estimate of pound miles of service for the fiscal years 1938 and 1939 would result in revenues of approximately \$14,000,000 and \$18,000,000, respectively. While this ratio is not controlling, the experience of three immediately past years cannot lightly be disregarded.

Aggregate cost of transportation. The order instituting the proceeding did not, in terms, extend to the determination of aggregate cost of transportation, or of the necessity for any reduction in rates to keep such aggregate cost within the anticipated postal revenue; but it is obvious that these matters constitute the real objective of the statute and this proceeding,

and the parties recognized this by introducing evidence bearing upon cost of transportation.

At the outset it is necessary to consider the extent of the service which is to be included in the determination of the aggregate cost. The act directs that the Commission fix rates for each route which, in connection with the rates "fixed by it" for all other routes, shall be designed to keep the aggregate cost within the anticipated postal revenue. At present there are 37 domestic air-mail routes. The Commission has fixed rates for 33 of these routes. Contracts for the other four routes were awarded during the present fiscal year after competitive bidding.³ By their terms these contracts will remain in effect for an initial period of 3 years, and the act contains no authority to adjust the rates during that period. These rates, of course, were not "fixed" by the Commission, and it is possible that the cost of transportation over these new routes should not be considered in determining the aggregate cost of transportation for the purposes of section 6(e). The provision requiring a relation between cost and postal revenues, however, was part of the original act which also restricted the Postmaster General from awarding contracts for routes in excess of an aggregate of 29,000 miles and from establishing schedules in excess of an annual aggregate of 40,000,000 airplane miles. At that time contracts had been awarded for substantially the entire amount of authorized route mileage, and in directing the Commission not only to fix fair and reasonable rates in lieu of the existing contract rates, but to fix those rates in such manner that compensation thereunder in the aggregate should be kept within the anticipated postal revenue by July 1, 1938, Congress apparently contemplated that a balance between the Government's income and outgo for all authorized service, including that compensated for at contract rates, would gradually be effected. By amendment of August 14, 1935, the limitations were increased to 32,000 route miles and 45,000,000 airplane miles. By amendment of January 18, 1938, these limitations were again increased to 35,000 and 52,000,000 miles, respectively, and by amendment of April 15, 1938, were again increased to 40,000 and 60,000,000 miles, respectively. If the service under the contracts for the four new routes awarded under these additional authorizations, or under any future contracts which may be similarly awarded, be disregarded in the application of the limitation of section 6(e), or, in other words, if contract rates be not included in the determination of aggregate costs, the apparent intent of Congress when the provision was enacted would be defeated. While the express terms of the act thus seem to be in conflict with its spirit there probably is no necessity for undertaking a positive construction of the language at this time. Operations over one of the four new routes had not yet been started by December 31, 1937, and the cost of transportation over the remaining three, because of exceptionally low bids, is shown to have been only about \$201 during approximately the first quarter year of operation ended December 31, 1937. On the basis of the estimate of an average of 1 mill per pound-mile, previously mentioned, the service on these routes during that period would indicate a revenue of approximately \$14,000.

Although the mandate to keep the aggregate cost within the anticipated

3. In May, 1938, bids were opened for 5 additional domestic air-mail routes, but contracts had not been awarded on the date of our decision in this proceeding.

postal revenue is directed to the establishment of rates by the Commission, it is obvious that cost of transportation can never be determined from a consideration of rates or service alone, because cost is the product of these two factors. Section 3(f) of the act gives the Postmaster General full authority to prescribe the number and frequency of schedules, the intermediate stops between termini of a route, and the time of departure of all planes carrying air mail; and authorizes him to utilize any scheduled passenger or express flight of a carrier whenever the needs of the service so require. Such authority has been exercised frequently in the past, and many changes have been made in the service required. Such changes undoubtedly will continue in the future. That section also authorizes the Postmaster General to compensate the carriers for special or extra or emergency trips in addition to regular schedules. Such compensation may be at the rate for regular schedules, or at a lesser rate if agreed to by the carrier and the Postmaster General.

While denying that responsibility for complying with this provision of section 6(e) rests upon him, as well as upon us, and contending that effect must be given to the provision solely through adjustment of rates to conform to changes in service which he is free to make within the limits of the specific provisions of the statute, the Postmaster General introduced estimates of the aggregate cost of the service for the fiscal years 1938 and 1939 which cover more than the payments to the air-mail carriers. Such payments are shown on the basis of the appropriation of \$14,788,000 for contract air-mail service for the fiscal year 1938 and the amount of such appropriation, \$15,800,000, estimated for the fiscal year 1939. These sums each include estimates of approximately \$100,000 for air-mail administrative expense. One witness testified that whatever sum Congress appropriates for any fiscal year is for all practical purposes the limit of the expenditure for air mail, but that increases in the rates fixed by the Commission would lead to a request for a deficiency appropriation. Request for a deficiency appropriation would be equally necessary in the event that substantial increases in service were authorized by the Postmaster General. It is, therefore, impracticable to determine the aggregate cost of air-mail transportation solely from a consideration of the amount of appropriation initially estimated or initially granted by Congress for that purpose for any fiscal year.

The total costs submitted for the fiscal years 1938 and 1939 are \$15,925,000 and \$16,982,000, respectively. The additional amounts over the estimated payments to the carriers represent charges for "railroad transportation," "mail messenger service," "vehicle service," and "railway mail service." The Postmaster General contends that transportation of air mail includes all services performed from the time such mail leaves the post office at the point of origin until it arrives at the destination post office, and that the cost of transportation of air mail within the meaning of section 6(e) should include the cost of all such services. Although his witnesses showed the amounts resulting from apportionment to air mail of other post office expenses, such as salaries of postmasters, post office clerks, and letter carriers, and electric and cable car service, power boat service, and rural delivery service, they concede that those items are not properly includable in the "cost of transportation."

The amount shown for "railroad transportation" is the payment for

rail transportation of air mail between post offices and airports. The charges for "mail messenger service" and "vehicle service" represent the expense estimated to be incurred for other handling of mail between post offices and airports. The charge for "railway mail service" is the expense incurred by the railway mail service for maintaining air mail field post offices, including the clerical force engaged at such places.

The carriers strongly urge that these items are not part of the "aggregate cost of the transportation of air mail" and that the proper interpretation of that term is the aggregate of the amounts paid to each of them for the transportation of air mail by airplane and the services performed by them in connection therewith. There seems to be no reason to question that interpretation. The provision of section 6(e) here considered is part of a direction to the Commission to consider certain things "in fixing and determining the fair and reasonable rates of compensation for air-mail transportation * * *." As pointed out in *Air Mail Compensation*, 206 I. C. C. 675, this portion of section 6(e) has meaning only by relation to section 6(a) which alone contains the power for fixing fair and reasonable rates. Under the latter paragraph rates are to be fixed "for the transportation of air mail by airplane and the service connected therewith over each air mail route * * *." If the words "transportation of air mail," as used in section 6(e), be construed to comprehend more than "the transportation of air mail by airplane," as used in section 6(a), the two provisions would unnecessarily be brought into conflict with each other. The additional items which the Postmaster General urges should be included as cost of transportation are not included in the purposes of the appropriations estimated and authorized for transportation of air mail; instead, such costs are appropriated and paid for separately.

Conclusions. The conclusions as to the spread between the estimated cost of air-mail transportation and the anticipated postal revenue therefrom which may be drawn from the evidence introduced by the Postmaster General for the fiscal year 1939 range from a deficiency of \$2,232,000 to an excess of \$2,200,000.

The deficiencies are predicated upon estimates of the future said to be determined with relation to past results under the cost ascertainment system. While the deficiency of \$2,232,000 represents the difference between the estimated revenues and the estimated cost of transportation, including the additional items which the Postmaster General urged should be considered, there is also a deficiency of \$1,050,000 when the revenues are compared with the payments to the air-mail carriers with the addition only of the air-mail administrative expense. The apparent excess in revenues results from comparison of revenues determined from estimated pound-miles of service with similar estimates of transportation cost.

The cost ascertainment system reflects apportionments of both total revenues and total expenses of the postal service between the various classes of service based upon tests of actual experience. Ordinarily, therefore, that system should afford better estimates of future probabilities than would estimates resting solely upon anticipated increase in the pound-miles. The question thus resolves itself largely into one of the adequacy of the cost ascertainment system for the determination of the amount of revenue accruing from air mail with sufficient accuracy to be used as a limitation upon rate making. The Commission is not bound, however, to accept

unqualifiedly the findings of that system, or the conclusions drawn from its use, merely because the system has been used for other purposes with satisfactory results for a number of years and because no other method of arriving at the anticipated or actual postal revenues from air mail was suggested during the hearings.

The evidence discloses that the revenues used in determining the deficiencies were based upon a less rapid growth of service during the fiscal years 1938 and 1939, than the rate of growth upon which the expenses apparently are based. This, of course, places revenues and expenses on different bases. If the expenses were determined with relation to the same leveling-off of service as was used in determining revenues, the estimates made through use of the cost ascertainment system itself would show an excess of revenue.

If the growth in service, revenues, and expenses shown for the fiscal years 1935, 1936, and 1937 were projected at the same average rate, the revenues and expenses for the fiscal year 1939 would be approximately \$17,500,000 and \$14,800,000, respectively, as compared with the cost ascertainment estimates of \$13,725,000 and \$15,800,000. The pound-miles of service would be approximately 18,500,000,000, which is substantially the same volume as used in determining the excess of \$2,200,000 in revenues over expenses previously described.

When the experiences of the fiscal years 1935, 1936, and 1937 are considered in the light of revenues and costs per unit of service, the same results for the fiscal years 1938 and 1939 are indicated. The cost of 1.3 mills per pound-mile in 1935 dropped to 1.2 mills in 1936 and to 1 mill in 1937, while the revenue remained practically constant at 0.97 mills. The estimates for 1938 show a slight increase in cost and a slight decrease in revenue, per pound-mile. The estimates for 1939 show sharp decreases in both cost and revenue to 0.86 mills and 0.8 mills, respectively. No reason is given for this decrease in revenues per pound-mile, and if the revenue per pound-mile realized during the preceding fiscal years were maintained, it is apparent that there would be an excess in revenue over cost, even without considering a reduction in cost figures in proportion to the experience of the past.

The figures for the fiscal years 1935, 1936, and 1937 upon which the foregoing probabilities for the fiscal years 1938 and 1939 are based, must, of course, be considered in the light of the carriers' claims of inadequacy of the cost ascertainment system for present purposes. The efficacy of the system for the purposes of the postal service generally is not questioned. It undoubtedly serves in a highly satisfactory manner the purposes for which it was intended, when inaugurated, and it is of little moment in that connection whether the relation of air-mail revenue to total revenue be stated in terms of 1.911 per cent, the ratio shown in the cost ascertainment report for the fiscal year 1937, or in terms of 2 per cent. The difference of .09 of 1 per cent, however, is of material importance in connection with a limitation upon the rates to be paid for the transportation of air mail. That difference represents nearly \$600,000 of the total "net related revenue from ordinary postage," and more than offsets the deficiency from air mail shown by the report for that year. An increase of that amount in the anticipated revenues obtained by projection of the revenue for the fiscal years 1935, 1936, and 1937 would bring the air-mail revenue for the fiscal

year 1939 to \$18,100,000, or \$2,300,000 more than the sum of the payments to the carriers plus the air-mail administrative expense estimated by the Postmaster General.

The record contains no adequate explanation of the manner in which the ratio of 1.911 per cent was obtained. It does show that in the actual count of all revenue and of air-mail revenue at all reporting first and second-class offices during the four count periods of the fiscal year 1937, air mail constituted 2.38 per cent of all revenue. On the other hand, the amount of revenue from all first and second-class offices apportioned to air mail in the cost ascertainment report for the entire year is only 2.02 per cent of the total revenues from those offices shown in that report. The total revenue at first and second-class offices constitutes slightly more than 91 per cent of such revenue at all offices.

Considerable variation also is noted between the ratio of air-mail revenue to total revenue as actually developed in the four count periods and as shown in the report for the year in respect of individual groups of offices. Out of the seven groups comprised in the first and second-class offices, the ratios for six groups as shown in the annual report are less than the ratios developed through the actual count. Since the periods of count are deliberately selected to avoid periods of unusually large mail volume, such as Christmas mail, it is reasonable to assume that no adjustment of the ratios developed through the actual count should be necessary to eliminate unusual conditions. This variation is especially noticeable in respect of the offices in groups A and B. These groups embrace first-class offices which have annual receipts of \$1,000,000 and over, and which contribute more than 50 per cent of the total "net related revenue from ordinary postage" and nearly 75 per cent of total domestic air-mail revenue. The ratios of air-mail revenue to total revenue, as developed during the four actual count periods, were 2.396 for group A, and 3.755 per cent for group B, as compared with ratios of 2.271 and 2.802 per cent, respectively, in the cost ascertainment report for the year.

The cost ascertainment system does represent actual experience, although that experience constitutes only a small part of the total experience it purports to ascertain; but no system embracing actual experience can be totally disregarded, especially in the absence of a better method which reasonably can be applied. It is the use of the system for present purposes which is of greatest importance, and, in the absence of clear and compelling reasons to the contrary, it would appear that if the system were used in such manner as to give full weight to the trends of the past it reasonably would be possible to ascertain "anticipated postal revenue" from air mail with sufficient accuracy for the purposes of the act.

We find that "anticipated postal revenue" for the purposes of section 6(e) may reasonably be ascertained by giving due consideration to a projection at the same rate of progression of the revenues for preceding years ascertained through the cost ascertainment system; to a like projection of pound miles of air-mail service during the same preceding years; and to any prospective changes affecting the service; that the periods for which such revenues should be anticipated should be each fiscal year beginning July 1st; and that for the fiscal year beginning July 1, 1938, it appears that the anticipated postal revenue from air mail so ascertained will be in excess of the aggregate cost of transportation of air mail by airplane

and the services performed by the carriers in connection therewith, which may be anticipated by projecting at the same rate of progression the cost of transportation for preceding years.

These findings do not, of course, preclude further consideration of any reduction in rates necessary for compliance with this mandate of the law in the event of unforeseen decreases in the revenue or increase in the cost of such transportation; nor do they preclude the Postmaster General from advising the Commission of any changes in revenues or cost of transportation as in his opinion warrant reductions in rates.

By the Commission, Division 3.

W. P. BARTEL,
Secretary.

(SEAL)

**INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 23**

Air Mail Rates for Route No. 8

Submitted May 3, 1938

Decided June 1, 1938

Rates of compensation for the transportation of air mail by airplane and the service connected therewith over air mail route No. 8, found not to have been fair and reasonable from and after May 28, 1937. Fair and reasonable rates determined and published.

A. Culbert for petitioner.

Karl A. Crowley and *William C. O'Brien* for the Postmaster General.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, MAHAFFIE, AND MILLER

BY DIVISION 3:

No exceptions were filed to the report proposed by the examiner. Our conclusions agree with those recommended by him.

By petition filed May 28, 1937, under the provisions of section 6(a) of the Air Mail Act of 1934, as amended, Chicago and Southern Air Lines, Inc., operator of air-mail route No. 8, seeks reexamination of the fair and reasonable rate for the transportation of air mail over that route as determined and published in *Air Mail Compensation*, 206 I. C. C. 675. The Postmaster General filed an answer denying that the present rate is less than fair and reasonable, and also filed a petition, similar to petitions considered in earlier cases, requesting that no hearing be had in this case under section 6(a) until the Commission has completed an audit and investigation of the carrier's books and records under section 6(b), from the date of the beginning of service on route No. 8 up to and including the last complete month of service prior to the filing of this petition. It has been decided that where a record contains evidence sufficient to permit of a determination of fair and reasonable rates under section 6(a), the act not only warrants but directs that such action be taken without delay for performance of duties under other sections of the act. *Air Mail Rates for Route No. 31*, 214 I. C. C. 387. The petition in this case was denied. Prior to the hearing,

however, a tentative report of an audit and investigation under section 6(b) for the period from the beginning of operations on route No. 8 through May 31, 1936, was served on the Postmaster General and the carrier. No hearing in that proceeding was requested and it was decided on September 7, 1937, *Chicago & Southern Air Lines, Incorporated, Rate Reviews 1935-1936*, 223 I. C. C. 535, prior to the conclusion of the hearing in this case. No unreasonable profit was found to have been derived or accrued from the rate of compensation paid for the transportation of air mail.

The termini of this route are Chicago, Ill., and New Orleans, La. Intermediate stops are scheduled at Peoria and Springfield, Ill., St. Louis, Mo., Memphis, Tenn., and Greenwood and Jackson, Miss.

Petitioner's predecessor, Pacific Seaboard Air Lines, Inc., began mail operations over this route on June 3, 1934, under a temporary contract entered into on May 14, 1934. At the expiration of the initial period the contract was extended for 9 months, and on June 1, 1935, was indefinitely continued. The contract rate was 17.5 cents per mile for an initial unit of 20 cubic feet of air mail space, one cubic foot being considered the equivalent of 9 pounds of mail. This rate was paid up to March 1, 1935. Pursuant to the provisions of section 6(c) of the act, as amended August 14, 1935, compensation since that date has been paid at the rate fixed by the Commission in *Air Mail Compensation, supra*. Under that decision the rate for an average load of 300 pounds or less is 29 cents per mile, with a base mileage of 110,000 per month. Automatic changes in rates are provided for variations in mileage flown and increases in the load to more than an average of 300 pounds. The air-mail contract requires the carrier to furnish passenger facilities.

Capitalization. Pacific Seaboard Air Lines, Inc., was incorporated June 15, 1933, under the laws of California with an authorized capital stock of 50,000 shares, par value \$1 per share. It operated an exclusive passenger and express service between San Francisco and Los Angeles, Calif., from June 25, 1933 to May 1, 1934. On June 3, 1934, when mail operations were started on route No. 8, the stock outstanding consisted of 35,000 shares, all owned by the president of the company. The name of the corporation was changed to Chicago and Southern Air Lines, Incorporated, on December 31, 1934. The present corporation, Chicago and Southern Air Lines, Inc., was organized under the laws of Delaware on December 30, 1935, with authority to issue 50,000 shares of \$10 par value convertible preference stock and 300,000 shares of no par value common stock. A total of 35,000 shares of convertible preference stock and 100,100 shares of common stock have been issued. The carrier received \$315,000 from the sale of preferred stock. The brokers who sold it to the public received a commission of \$35,000 and 15,000 shares of the common stock. From time to time the president and certain other officers had made advances of cash and equipment to the old company. The indebtedness resulting therefrom amounted to \$242,543 as of the date of formation of the new company. No liability for this indebtedness was assumed by the present company, but the remaining 85,100 shares of its outstanding common stock were issued to the president as voting trustee for himself and the other officers who had made the advances to the old company. All other liabilities of the old company were assumed, and its assets were received, by the present company.

At the beginning of mail service, the books reflected a paid-in surplus

of \$79,413. The carrier charged against this amount not only the deficit accrued since the beginning of mail operations but also the loss from operations prior to that time. It also credited to profit and loss back mail pay for the period March 1, 1935 to June 30, 1935. The recorded deficit as of December 31, 1935, was \$158,703. This deficit was not carried to the books of the new company, as the debts owed the officers of the California company were not assumed. In the balance sheet of the new company, before giving effect to the refinancing plan and the issuance of the preferred stock, the difference of \$118,841 between the assets received, including \$1 for the air-mail contract, franchises and goodwill, and the liabilities assumed, was set up by the new company as \$25,000 paid-in surplus, and \$93,841 capital stock liability on account of the 85,100 shares of stock issued to the president as voting trustee. The balance sheet, after giving effect to the refinancing plan, shows total assets and liabilities of \$505,518, including the same amount for the air-mail contract, franchises and goodwill. An additional capital stock liability of \$350,000 was set up for the 35,000 shares of preferred stock issued, but no increase in the liability for common stock was recorded, although the number of shares issued and outstanding was increased to 100,100. Total assets and liabilities at June 30, 1937, had decreased to \$499,524. Capital stock liability for the 100,100 shares of common stock had been increased to \$111,091 and the paid-in surplus of \$25,000 had been converted into a deficit of \$1,329.

Investment. When mail operations were started under the contract the flying equipment consisted of five Bellanca monoplanes and a Pitcairn biplane, and seven Wright engines. This equipment had been acquired while the carrier was conducting operations on the Pacific Coast prior to the time it was awarded the contract for route No. 8. The books covering operations on the mail route were opened as of June 1, 1934, and the property acquired during prior operations was set up therein at net book value. The investment in aircraft, engines, and aircraft communication equipment was shown in the accounts at that time as \$21,000, \$10,000 and \$3,000, respectively. Another Bellanca plane was acquired shortly thereafter to replace one which had been damaged in an accident. In the latter part of 1934, and early in 1935, tri-motor Stinson planes were substituted for the Bellancas, and these, in turn, were replaced on April 30, 1936, by twin-engine Lockheed Electras. Four of these planes were secured on the latter date, one was destroyed in an accident on August 5, 1936, and replaced by another acquired on September 10, 1936. The carrier's investment in real property and equipment as of March 1, 1935, when the rates fixed by the Commission in *Air Mail Compensation, supra*, were made effective by section 6(c), was \$69,776, and accrued depreciation was \$14,219, leaving a net book value of \$55,557. As the result of additions, betterments and retirements the investment in real property and equipment, depreciation and net book value as of June 1, 1937, were \$280,411, \$85,024, and \$195,387, respectively.

The amounts included in the latter figures for flying equipment were \$229,980, \$71,893, and \$158,087, respectively. At that time the carrier was using regularly in the operation of the route four Electra planes. One Stinson and one Pitcairn were used for training flying personnel. Another Electra was purchased on July 19, 1937, and is used as reserve equipment. The president and vice president also use their privately owned planes in educational flights, courtesy hops, etc., at no cost to the carrier except

servicing and storing. No repairs to these planes are contemplated except in case of damage while in service of the carrier.

Operations. The carrier began mail service on June 3, 1934, and passenger service on July 15, 1934. The territory traversed is generally low and level. There are extensive areas of swamp lands and open water on the southern end, and intense fogs are encountered frequently on most of the route. During winter months icing conditions along the northern portion render operations difficult and expensive. Stormy weather is sometimes experienced all along the route in an area approximately 200 miles in width, necessitating cancellation of schedules. There are few satisfactory emergency landing fields and during the winter most of them are unusable.

One round trip daily was scheduled between Chicago and New Orleans until April 1, 1935. Since that time two round trips have been scheduled, one in day flying and one at night. The day trip was not operated on Sundays and holidays until June 16, 1937. On June 1, 1937, the Postmaster General changed the schedules on the night trips so that the south bound plane arrives at New Orleans at 3:18 a. m., and the north bound plane reaches Chicago at 3:21 a. m. They formerly arrived at 11:38 p. m., and 11:35 p. m., respectively. From the evidence it would seem that these changes in schedule will cause more cancellations of scheduled flights because fog conditions are worst at about the time the planes are to reach their destinations. It is also shown that beginning with the change in the night schedules passenger traffic on both trips has been less than for the same months of the previous year. The reductions in passenger revenues for June and July of 1937, as compared with the same months for 1936, were \$3,426.01, and \$4,397.26, respectively. The change in night schedules also made it necessary to employ additional maintenance and operating personnel at several points on the route at additional salary cost of \$875 per month.

The carrier has operated extra sections on its mail schedules on occasions when sufficient passenger traffic was available to make them profitable. The total mileage so flown from July 15, 1934 to May 31, 1937, was approximately 9,000 airplane miles. The carrier's annual report for the fiscal year ended June 30, 1937, shows only 1,289 miles flown in exclusive-passenger service. With the exception of this mileage the carrier did not operate any nonmail schedules until September 1, 1937. On the latter date a round trip passenger schedule was inaugurated over the route to off-set the loss in passenger traffic occasioned by the change in schedule as of June 1, 1937, discussed above. There is not sufficient evidence in the record to show whether this schedule will prove to be a profitable operation. No weight-credit service had been operated by the carrier as of the date of the hearing.

During the period June, 1934 to January, 1935, inclusive, when operations were conducted with Bellanca equipment, the carrier performed 394,033 miles in revenue service, which amounted to 90.9 per cent of the total miles scheduled. The mail transported averaged 48.6 pounds per mile flown. A total of 841 revenue passengers were carried 261,644 passenger miles, and the average number of passengers carried was .66 per mile flown. Of the seat miles operated 20.1 per cent were occupied by revenue passengers. During the period when Stinson equipment was used, from February, 1935 to April, 1936, inclusive, 1,275,042 miles were flown, resulting in a performance

of 89.2 per cent of the miles scheduled. The mail carried averaged 53.8 pounds per mile, and the revenue passengers carried totaled 6,363. Of the seat miles operated 27.5 per cent were occupied, and the revenue passengers averaged 1.8 per mile flown. During May, 1936 to May, 1937, inclusive, operations were conducted with Electra planes. The revenue miles flown totaled 1,204,785 which is 93.1 per cent of the miles scheduled. The mail transported averaged 65.8 pounds per mile. The revenue passengers carried totaled 12,122 and the average load was 3.8 passengers per mile flown. Of the seat miles operated, 47.6 per cent were occupied by revenue passengers.

During the period May 1, 1936 to April 30, 1937, when Lockheed Electras were operated, the passenger revenue per mile flown was 17.49 cents, whereas the expenditure for traffic and advertising amounted to 7.2 cents per mile. This expenditure was 4.1 per cent of the passenger revenue and was, in our opinion, excessive. In *Air Mail Compensation, supra*, traffic and advertising expenses for the air-mail contractors as a whole averaged 4.7 cents per mile.

Results of operation. After the carrier had introduced its evidence a continuance was granted to enable the Postmaster General to dispose of certain matters relating to observance of the uniform system of accounts for air-mail carriers prescribed by him. Many changes in the carrier's books were required, most of which related to small and relatively unimportant items and to transfers of charges and credits from one operating period to another.

The carrier's books, as thus corrected, show a net deficit from operations of \$94,782 during the period June, 1934 to May, 1937, inclusive, including taxes assignable to operations. These corrections include elimination of monthly charges of \$1,300 from November, 1936 to May, 1937, inclusive, accrued as salaries of the president and vice president, and a charge of \$2,182.80 representing the cost of repairing a plane owned by the vice president, following an accident occurring off the air mail route. The carrier contends that these are proper items of expense to be considered in determining fair and reasonable mail rates.

The president and vice president have never received any salaries for services rendered to the carrier or its predecessor. Moreover, during most of the period of mail operations funds were advanced by these officers to cover operating deficits. In the reorganization of the corporation it was agreed that no salaries should be paid these officers until the carrier was on an "earning" basis. Both of these officers, however, devote their entire time to the service of the carrier, and any question of actual payment of salaries for those services under the underwriting agreement, or the propriety under the system of accounts of accruing such salaries on the books of the carrier, does not, of course, preclude us from taking them into consideration in determining reasonable rates.

In respect of the cost of repairing the plane owned by the vice president, the carrier contends that the flight on which the accident occurred was in the nature of a goodwill flight and should be considered as an advertisement of the services available to the public on the route, and that consequently the cost of repair constitutes a proper element for consideration in fixing reasonable rates. Whether this flight should be regarded as in the service of the carrier, it is apparent that the expense, which was incurred

in 1936, is one of a nonrecurring nature and of relative unimportance for the purpose of this proceeding.

The evidence relating to the net deficit from operations during the entire period as presented by the carrier shows that the losses were greatest during the early part of the period when Bellanca equipment was used. Following the change to Stinson equipment in 1934 and 1935 a decided increase in passenger revenues was experienced but operations were still conducted at a loss. Following the installation of Electra equipment during 1936 another marked increase in passenger revenues developed, and for the last year of the period under consideration a small profit was realized from operations without payment of salaries to the president or vice president.

The same deficit was presented by the Postmaster General in a manner to show the results for five separate periods, viz.: June 1 to June 30, 1934; July, 1934 to June, 1935; July, 1935 to December, 1935; January, 1936 to June, 1936, and July, 1936 to May, 1937, all inclusive. The net income from operations for these several periods are shown as \$8,232.68,* \$81,069.41,* \$2,590.14, \$17,989.20* and \$9,919.22, respectively. The testimony of a witness for the Postmaster General indicates that the net income from operations shown for the period July, 1936 to May, 1937, includes accounting adjustments for transactions relating to prior periods. The record does not show the exact amount of all such adjustments, but it is contended by the carrier that they amount to approximately \$1,200. Deduction of that amount from the net income of \$9,900 shown by the Postmaster General would leave \$8,700 as the income from operations during that period. In the latter figure, of course, no consideration is given to the payment of salaries to the president and vice president of the company. The amount accrued by the carrier during that period for such salaries was \$9,100, and if this amount had been paid the results of operations during the period would have been a deficit.

The evidence submitted by the carrier indicates that operating expenses in the future will further exceed revenues, even with increases in revenues from sources other than mail transportation which may reasonably be anticipated from operation of the route. It is shown that wages of personnel will be higher than formerly and that additional employees must be secured; that prices of some materials and supplies have risen; that rentals and taxes, particularly social security taxes, an expense not contemplated when the present rates were fixed, will be increased. The change in the night round-trip schedule makes it unattractive to passengers. Passenger revenues show a decrease for the first 2 months following this change. In addition to the extra personnel expense of \$875 per month resulting from the change in schedules, other increases in wages are required by an agreement between the carrier and its employees, effective August 1, 1937. Among other provisions the agreement calls for payment of time and a half for over-time which had not been paid theretofore.

The Postmaster General contends that the mail rate should not be increased and has submitted several analyses on a ton-mile basis, assuming that each passenger and his baggage weighs 200 pounds. In some of the computations the weight of the mail is assumed to be 300 pounds. The revenue per ton-mile from mail is much greater than from passengers. The

* Denotes deficit.

revenues per airplane mile in revenue service are also shown to be much greater from mail than from passengers. It is evident, however, from the record in this case that schedules are operated primarily for the purpose of handling air mail.

Conclusion. Since the present rates were prescribed by the Commission, operating and traffic conditions have made it necessary for the carrier to secure more expensive flying equipment. Direct competition is encountered from American Airlines, Inc., between Chicago and St. Louis, and between Chicago and Memphis by a circuitous route. Railroads also compete with all parts of the route for passenger and express traffic. While operating expenses have been increased by higher charges for depreciation on the more expensive equipment, the operating losses have been reduced due to the more favorable results from passenger operations.

We find:

1. That the rates of compensation for the transportation of air mail by airplane and the service connected therewith over route No. 8 were not fair and reasonable from and after May 28, 1937, the date of the filing of the petition herein;

2. That the fair and reasonable rates of compensation for the transportation of air mail by airplane and the service connected therewith over route No. 8 from and after May 28, 1937, the date of the petition herein, were, are, and will be for each airplane mile actually flown with mail, subject to the provisions of section 3(f) of the act, the rates for 300 pounds of mail or less determined by applying the provisions of the Commission's order in *Air Mail Compensation*, *supra*, as amended, to a base rate of 32 cents per airplane mile for a base mileage of 110,000 miles per month.

An appropriate order will be entered.

MAHAFFIE, *Commissioner*, concurring in part:

So far as rates for the future are concerned I agree. For the reasons stated in 216 I. C. C. 166, at page 191, I would not make the finding retroactive.

Order

At a session of the INTERSTATE COMMERCE COMMISSION, Division 3, held at its office in Washington, D. C., on the 1st day of June, A. D. 1938.

Air Mail Docket No. 23

Air Mail Rates for Route No. 8

Investigation of the matters and things involved in this proceeding having been made, and said division having, on the date hereof, made and filed a report containing its findings of fact and conclusions thereon, which report is hereby referred to and made a part hereof:

It is ordered, That the rates of compensation for the transportation of air mail by airplane and the service connected therewith over route No. 8 from and after May 28, 1937, the date of the petition herein, be, for each airplane mile actually flown with mail, subject to the provisions of section 3(f) of the Air Mail Act, as amended, the rates for 300 pounds of mail or less determined by applying the provisions of the Commission's order in *Air Mail Compensation*, 206 I. C. C. 675, as amended, to a base

rate of 32 cents per airplane mile for a base mileage of 110,000 miles per month.

By the Commission, division 3.

W. P. BARTEL,
Secretary.

(SEAL)

**INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 31**

Western Air Express Corporation, Rate Review 1935-1936

Submitted November 22, 1937.

Decided January 22, 1938

Upon review of air-mail rates of compensation being paid on route No. 13, no unreasonable profit found to have been derived or to be accruing therefrom to the carrier for the period May 8, 1934 to June 30, 1936.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, PORTER, AND MILLER

BY DIVISION 3:

No exceptions were filed to the tentative report of the examiner, which was served upon the Postmaster General and Western Air Express Corporation, hereinafter called the carrier.

This is a proceeding under paragraph (b) of section 6 of the Air Mail Act of 1934, as amended, to renew the rates of compensation being paid to the carrier under its contract for the transportation of air mail by airplane and the service connected therewith over route No. 13, between Salt Lake City, Utah, and San Diego, Calif., a distance of about 780 miles, to determine whether any unreasonable profit is being derived or accruing therefrom.

On May 3, 1934, a temporary contract for a period of 3 months for air mail service over route No. 13 was awarded to the General Air Lines, Inc., and such service was inaugurated on May 8, 1934. At the end of the temporary period the contract was extended an additional 9 months, and effective January 1, 1935, was assigned to the carrier which has since operated the route. On May 8, 1935, the contract was indefinitely continued. General Air Lines, Inc., bid 24 cents for each mile flown with mail scheduled and authorized by the Postmaster General. This rate was applicable for an initial unit of 40 cubic feet of air-mail space, one cubic foot being considered the equivalent of 9 pounds of mail. Under date of March 11, 1935, the Commission found the fair and reasonable rate for the transportation of 300 pounds of air mail or less over this route to be 33-1/3 cents per airplane mile for a base of 45,000 miles, subject to the provisions of the order in *Air-Mail Compensation*, 206 I. C. C. 675, 724, requiring changes in the base rate for variations in the mileages flown and excess loads. Section 6(c), as amended August 14, 1935, made the rate so prescribed applicable as the rate of compensation from March 1, 1935.

An audit of the books, records, and accounts, and a review of the operations of the carrier and its predecessor for the period from the be-

ginning of operations under the contract to June 30, 1936, together with the investigations in other respects directed by section 6(b), have been made for the purposes of this proceeding. A report on the audit was made to the Postmaster General, as required by section 10.

Capitalization. The carrier was incorporated October 1, 1928, under the laws of Delaware, with an authorized capitalization of 500,000 shares of common stock of \$10 par value, as a holding company for Western Air Express, Inc. The latter corporation was organized July 13, 1925, as an operating company, with an authorized common stock of 5,000 shares of \$100 par value. On February 1, 1929, the carrier exchanged each 25 shares of its stock for one share of Western Air Express, Inc., stock. In order to meet the requirements of the Air Mail Act of 1934, General Air Lines was incorporated April 17, 1934, under the laws of Delaware with an authorized capital stock of 25,000 shares of \$10 par value. This corporation was an operating company only and owned no equipment or other property, its only assets consisting of \$100,000 cash, being the proceeds from the sale of 10,000 shares of its \$10 par value stock to North American Aviation, Inc., on April 19, 1934. The latter sold this stock to the carrier at the same price on June 26, 1934. Upon the assignment of the mail contract, January 1, 1935, the carrier assumed the assets and liabilities of both General Air Lines and Western Air Express, Inc. General Air Lines was dissolved March 13, 1935, and the dissolution of Western Air Express, Inc., is pending.

Of the carrier's authorized capital stock, 234,102 shares were issued initially, some of which were subsequently reacquired and canceled. On July 31, 1935, the number of shares outstanding was 222,645. There was no change in the outstanding stock between that date and the close of the audit period. On December 27, 1934, when the carrier disposed of other air transport interests, the par value of its stock was reduced from \$10 to \$1 per share, and a liquidating cash dividend of \$2.50 per share, made possible by the sale of certain securities, was paid January 31, 1935. There was no funded indebtedness during the audit period.

Investment. General Air Lines, Inc., owned no real property or flying equipment, but leased from Western Air Express, Inc., substantially all of the latter's real property and equipment at a rental of \$7,000 per month. As of the date of the lease, May 5, 1934, the leased property and equipment had an original cost of \$580,107 and a net book value of \$140,583, of which \$64,584 and \$39,382, respectively, represented property located at off-line points not used in operations on the route. Much of the equipment on the route was obsolete and was sold during the term of the lease, the lessor purchasing and including in the lease four new Douglas DC-2 planes to take the place of units sold. The new planes, which represented an investment of \$325,414, including engines, were leased and placed in service October 15, 1934. They were sold by the lessor to Eastern Air Lines on December 31, 1934. The carrier operated with leased equipment during most of the period prior to July 31, 1935. On that date its recorded investment in real property and equipment used in operations on the mail route was \$329,639. Reserves for depreciation thereon amounted to \$99,134, leaving a net book value of \$230,505. As a result of additions, betterments, and retirements between August 1, 1935, and June 30, 1936, the ledger value of the property on the latter date was \$387,900, the depreciation reserve \$187,211, and the net book value, \$200,689.

The planes leased at the beginning of mail operations by General Air Lines consisted of five F-10-A Fokkers, three Fokker Super-Universals, two Boeing 95's, a 40-B-4 Boeing, and one Stearman. These planes were manufactured in 1929, except the 40-B-4 Boeing and the Stearman which were manufactured in 1930. On May 5, 1934, the date of the lease, all of these planes, with the exception of the Stearman, were fully depreciated on the owning company's books, and on that date the net book value of aircraft costing \$177,102 new was \$2,492. Mail and passenger service was performed with the five F-10-A Fokkers until October 15, 1934, when the new Douglas transports were placed in service.

When the carrier began operations on January 1, 1935, it acquired from Western Air Express, Inc., the planes formerly leased to General Air Lines, except the Douglas planes, and in addition leased three used Boeing 247 planes from United Air Lines Transport Corporation at a monthly rental of \$1,560 each. The Boeing planes were placed in service on January 5, 1935. The lease contained an option of purchase at book value on the date the planes were delivered, and provided that rentals paid should be applied on the purchase price. One plane was returned to the lessor on July 3, 1935. The two remaining planes, together with two others, were modernized by United as model 247-D and bought by the carrier during May, June, and July, 1935. In addition to the rentals already paid, amounting to \$29,536, the carrier executed notes for \$73,795 and entered the planes on its books at the latter amount. Their book value to United as of the dates of delivery was \$104,470.

At the end of February, 1935, the carrier had sold all of the planes it acquired from Western Air Express, Inc., with the exception of the Stearman, receiving therefor \$5,250. The Stearman plane was retained and used for instrument flying instruction. It was damaged in October, 1935, and in the settlement with the insurance company was repurchased for \$300. It was rebuilt at a cost of \$2,386.32 and was still in service on June 30, 1936. One of the Boeing planes used in regular service was accidentally destroyed on September 1, 1935. On September 5, 1935, a slightly used remodeled Boeing, 247-D, was purchased at a cost of \$49,022. Thus on June 30, 1936, the carrier's flying equipment consisted of four Boeing 247-D's and one Stearman. The ledger value of this equipment, together with spare propellers, on that date was \$143,540 and its net book value \$87,658.78.

With the planes leased on May 5, 1934, were 36 Wasp and 8 Hornet engines, having a net book value of \$36,384. All but one of these were sold at various dates between June 25, 1934, and February 28, 1935. A net loss of \$6,833 was sustained in the disposition of these engines.

The carrier contracted with United to pay \$2.15 per hour of operation for the use of each Wasp engine leased with the Boeing planes. The engine hours of use during the period of the lease aggregated 5,235. When the planes were purchased, the carrier also purchased from United 10 new geared Wasps for \$69,649 cash and an allowance of \$1,000 for each of the old engines purchased under the lease. Four additional geared Wasp engines were purchased subsequently and two were lost in the September accident. As of June 30, 1936, the ledger value of the carrier's engines was \$89,197 and the net book value \$44,665.

The airport at Las Vegas, Nev., represents an investment by the carrier of \$13,257. Other principal items of owned property were furniture and

fixtures, lighting, hangar, and shop equipment. Buildings and improvements owned had a net book value on May 5, 1934, of \$38,014, most of which consisted of a passenger station, water tower, garage, radio shack, wiring and electrical equipment, and field and runways at Las Vegas, and a hangar at Salt Lake City. The net book value of buildings and improvements at the end of the audit period was \$27,441.

Operations. Route No. 13 is described in detail in *Air-Mail Compensation, supra*, page 739. From the beginning of mail operations to the end of the audit period one daily round trip in mail service was scheduled between Salt Lake City and San Diego and from February 15, 1935, an additional round trip daily, except Sundays and holidays, was scheduled between Salt Lake City and Los Angeles. Beginning March 15, 1936, the latter schedule was authorized daily. Effective April 1, 1936, a daily round trip in weight-credit service was authorized between Salt Lake City and San Diego, in addition to a daily weight-credit schedule¹ from San Diego to Los Angeles, and a similar schedule daily, except Sundays and holidays, from Los Angeles to San Diego.

The passenger and express service between Salt Lake City and Los Angeles coincided with the mail service between those points throughout the period, except that an additional daily round trip was operated exclusively for passengers and express from May through August, 1934, and from July through October, 1935, and the schedule authorized to carry mail daily, except Sundays and holidays, from February 15, 1935 to March 15, 1936, was flown on Sundays and holidays exclusively for passengers and express. Between Los Angeles and San Diego the passenger and express service coincided with the mail service until May, 1935, when a second daily round trip was inaugurated exclusively for passengers and express which was later authorized as weight-credit service. A third daily round trip between the latter points was added in June, 1935. No scheduled off-line operations were conducted during the period under review.

During the 10 months prior to March 1, 1935, 661,773 airplane miles were flown, of which 503,759 were in mail-passenger service, 155,398 in exclusive-passenger service, and 2,616 in weight-credit service. For the year beginning March 1, 1935, when the rates prescribed in *Air-Mail Compensation, supra*, became effective, the carrier flew 1,315,670 airplane miles, of which 984,162 were in mail-passenger service, 300,325 in exclusive-passenger service, and 31,183 in weight-credit service. For the 4 months from March 1, 1936 to June 30, 1936, its planes were flown 535,954 miles, of which 362,773 were in mail-passenger service, 6,114 in exclusive-passenger service, and 167,067 in weight-credit service. Under the instructions of the Postmaster General the carrier's reports classify and include weight-credit service with exclusive-passenger service.

The mail carried during the period prior to March 1, 1935, totaled 206,004 pounds, an average load of 268 pounds per airplane mile; during the succeeding 12-month period, 320,379 pounds, an average load per airplane mile of 189 pounds, and, during the period from March 1, 1936 to June 30, 1936, 154,324 pounds, an average load of 328 pounds. Revenue passengers totaled 5,320, 14,387, and 6,408, respectively, and the ratio of revenue-passenger miles to seat miles flown, or load factor, was 40 per cent for

1. For description on weight-credit schedules, see *Air-Mail Compensation, supra*, page 714.

the first two periods and 47 per cent for the succeeding 4-month period. The number of passengers per month increased substantially over the number carried during the corresponding month of the previous year. Express traffic was handled under contract with the Railway Express Agency.² Express carried during the 10 months prior to March 1, 1935, totaled 55,262 pounds; for the year ended February 29, 1936, 229,317 pounds, and for the 4 months ended June 30, 1936, 163,738 pounds. As in the case of passenger business, the volume of express carried has shown a more or less constant increase.

Revenues, expenses, and income. Operating revenues recorded during the period from beginning of mail operations to March 1, 1935, were \$270,822, of which \$112,425, or about 41.5 per cent, were from mail, and \$130,002, or about 48.0 per cent, from passengers. For the first full year of operations under the mail rates fixed by the Commission, the operating revenues were \$627,593, of which \$315,868, or 50.3 per cent, were from mail and \$277,835, or 44.3 per cent, from passengers. For the last 4 months of the audit period the total revenue was \$246,489; \$109,675, or 44.5 per cent, from mail, and \$121,123, or 49.1 per cent, from passengers.

Operating expenses recorded during the period prior to March 1, 1935, were \$367,675; for the year ended February 29, 1936, \$583,834, and for the 4 months ended June 30, 1936, \$219,037. Thus, from operations there was a net deficit of \$96,853 for the first period, and net revenue of \$43,759 and \$27,451, respectively, for the succeeding periods. Taking into consideration taxes assignable to operations and uncollectable revenues, the net result from operations becomes for the period prior to March 1, 1935, a deficit of \$97,480; for the year ended February 29, 1936, an income of \$39,626, and for the 4 months ended June 30, 1936, an income of \$25,940.

The income for the year ended February 29, 1936, does not, however, reflect certain amounts arising out of the loss of the Boeing plane. The insurance recovery on this plane, \$28,783, was less than the net book value of the plane, \$34,925, at the time of its loss, including additions and betterments of \$368. This difference of \$6,142, which is less than the depreciation which would have accrued on the plane from that time to the end of the year, together with other items pertaining to final settlement of the insurance, were carried directly to profit and loss. If these items, aggregating \$7,815, had been taken into consideration in connection with the operations during the year the net income from operations would have been \$31,811.

One of the major items of expense reflected in the carrier's accounts is that of depreciation. Since General Air Lines owned no planes or engines it made no charges for depreciation on such property, nor did the carrier make such charges on the planes and engines taken over from Western Air Express, Inc., which had been fully depreciated. In the case of the Boeings purchased from United, depreciation was charged on the basis of a service life of 2 years from the date of purchase. These planes were then about 2 years old, making an over-all service life of about 4 years. Depreciation charges on the Boeing purchased direct from the manufacturer were computed on the basis of a service life of 3 years. Charges for depreciation on the geared Wasp engines, purchased new for use in the

². For description of express service, see *Air-Mail Compensation*, 206 I. C. C. 687-688.

Boeings, were made on the basis of a service life of 3,000 flying hours. No allowance was made for salvage value in computing depreciation charges on any of the equipment. Depreciation charges on aircraft and airway communication equipment were at the annual rate of 50 and 33-1/3 per cent, respectively. The hangar at Salt Lake City is being depreciated over a 10-year period. Other depreciation charges were relatively unimportant. For the year ended February 29, 1936, the depreciation charges for aircraft aggregated \$39,734.46 and for engines \$29,953.65. Like charges for the 4 months ended June 30, 1936, were \$20,403 and \$15,085, respectively.

The carrier's operation with its Boeing planes have not been sufficiently extended to afford a basis for finding that its charges for depreciation are excessive. However, it should be pointed out that United, as of December 31, 1935, increased the estimated service life of its Boeings to 4 years with a salvage value of \$5,000 and of its S1H1-G engines to 3,000 hours with a salvage value of \$500 each.

Exclusive passenger operations. As heretofore shown, during most of the period here involved the carrier maintained exclusive passenger service, in addition to its regularly scheduled mail operations. The amount of passenger revenue received from this source has been estimated by applying to the total passenger revenue the ratio of exclusive passenger miles flown, including weight-credit service, to the total revenue passenger miles. Upon this basis, exclusive passenger revenues were determined to be \$33,425 for the period prior to March 1, 1935, \$74,265 for the year ended February 29, 1936, and \$36,288 for the 4 months ended June 30, 1936. Revenues from express and excess baggage in such service were estimated on the basis of airplane miles flown to have been \$2,909, \$5,227, and \$4,906 for the respective periods.

In *Air Mail Rates for Route No. 24*, 222 I. C. C. 749, 758, we found that where the Postmaster General has duly authorized a mail schedule on a weight-credit basis, and mail is so carried, such schedule is not a nonmail schedule within the meaning of section 6(e) of the act. Eliminating the revenues from weight-credit schedules upon the basis of miles flown, the revenues from exclusive-passenger operations, including express and excess baggage, would be \$36,310 for the period prior to March 1, 1935, \$72,871 for the year ended February 29, 1936, and \$1,497 for the last 4 months of the audit period.

Beginning July 1, 1935, the Postmaster General required the carrier to report separately for mail-passenger schedules and for exclusive-passenger schedules, direct aircraft operating expenses.⁸ For the period prior to July 1, 1935, it is necessary to resort to an estimate based upon the ratio of exclusive-passenger miles flown to total mileage in order to approximate such costs. Eliminating the costs assignable to weight-credit schedules, the direct aircraft operating costs for the exclusive-passenger schedules during the period prior to March 1, 1935, would be about \$37,001; for the year ended February 29, 1936, \$81,857; and for the 4 months ended June 30, 1936, \$1,688. Depreciation of aircraft, being computed upon a yearly basis, would accrue on the carrier's planes whether they were operated in passenger service or not, and there is no indication that the carrier would be

8. Direct aircraft operating expenses are the costs necessary to keep the plane in the air, and include such items as repairs and depreciation of aircraft, engines and communication equipment; wages of flying personnel; cost of fuel and oil; and passenger supplies and insurance.

able to render efficient mail service with fewer planes. Under the circumstances it would appear improper in this case to include aircraft depreciation as an additional operating expense occasioned by the exclusive passenger schedules. With this item eliminated, the costs for the respective periods would be reduced to about \$36,569, \$72,598 and \$1,444, respectively. Upon this basis it is apparent that the revenues received from exclusive passenger schedules substantially equalled the additional expenses incurred in their operation.

Expenditures. A check of all vouchers, invoices, and expenditures from beginning of operations under the mail contract to the close of the audit period, June 30, 1936, discloses prices paid for goods and services have been in substantial agreement with market prices and at times have been less.

Major overhaul work of the carrier's Boeings was performed by United at the latter's shops. The engine overhaul was largely handled by Pacific Airmotive Company, the average cost being about \$400 per engine.

The carrier's pay roll expenditures comprise one of the most important items of expense incurred in its operations. At the beginning of mail operations under the contract, General Air Lines employed 73 persons. On July 31, 1935, the number of employees had been increased to 86, and by the close of the audit period to 99. Of the latter number, 32 were included in the classification of flying personnel. Pilots and copilots were paid in accordance with the scale prescribed by the National Labor Board. Since January, 1935, flying crews have included stewardesses at salaries ranging from \$100 to \$140 each per month. For the period prior to March 1, 1935, the carrier's pay roll expenditures totaled \$149,985; for the year ended February 29, 1936, \$215,009, and for the 4 months ended June 30, 1936, \$83,026. An analysis of the pay roll expenditures for June, 1936, reveals that approximately 49 per cent was for flying personnel, 29 per cent for operations and maintenance, 6 per cent assignable to traffic, 7 per cent to general office, and 9 per cent to administrative personnel.

Gasoline purchased during the period cost \$187,000. Delivered prices at Burbank, Calif., Las Vegas, and Salt Lake City, under contract ranged from 11.75 cents per gallon to 12.25 cents per gallon. Small quantities were purchased at various local points at prices ranging from 20.2 cents per gallon to 30 cents per gallon. The average price, including taxes, paid during the period May 8, 1934 to July 31, 1935, was 14.4 cents, and for the period August 1, 1935 to June 30, 1936, 14.6 cents per gallon. A State gasoline tax of 3 cents per gallon in California and 4 cents per gallon in Nevada is refundable. A similar tax of 4 cents per gallon in Utah is refundable only as to gasoline used outside the State. Oil purchases during the period totaled \$13,286 at an average price of about 42 cents per gallon. Most oil was purchased under contract at 38.5 cents f.o.b. airports at Los Angeles, Las Vegas, and Salt Lake City.

All of the insurance coverage is carried with insurance companies. For the period from May 8, 1934 to July 31, 1935, recorded expenses for insurance totaled \$35,955, and for the period from August 1, 1935 to June 30, 1936, \$37,295. The per-mile cost of insurance is comparatively low, averaging less than 3 cents per mile. The charges for passenger liability insurance are unusually low.

Interlocking relations. The only registered holder of more than 5 per cent of the carrier's outstanding capital stock does not own the beneficial interest in any of this stock, but holds title to 78,988 shares and 45,000, respectively, for two individuals. One of these latter is the beneficial owner of 100 shares of the common stock of Union Pacific Railroad Company, a vendor of the carrier. With this exception neither individual had any interest in any of the carrier's vendors.

None of the officers or employees has any interest in any vendor or lessor of the carrier and it does not appear that any of its stockholders, officers, or employees benefited, either directly or indirectly in any of its purchases or rentals.

Conclusion. Section 6(b) of the act under which this proceeding is instituted, requires the Commission to examine annually the books, accounts, contracts, and entire business records of each holder of an air-mail contract in order to be assured that no unreasonable profits are derived or accruing from the mail rates. In complying with this mandate it is incumbent on the Commission to determine not only that the carrier's books show no excessive profits, but also that its accounts have been so maintained as accurately to reflect the results of operations, and that potential profits have not been diverted through collusive arrangements or dissipated by unwarranted expenditures or uneconomical operations.

In this proceeding it appears that the carrier's books fairly reflect the results of operations over this route, and that the line has been operated as economically as is consistent with safety and the development of potential traffic. The per-mile operating cost recorded at 44.38 cents for the year ended February 29, 1936, compares favorably with other airlines operating in the same general territory with similar equipment. There is no indication of collusion in the purchase of goods or services.

The act does not specify what constitutes an unreasonable profit, nor does it set forth a base to which earnings should be related in the determination of whether or not such profits were accrued. The carrier's property is devoted to the public service, and in keeping with the established law it is entitled to earn a reasonable return upon the fair value of such property. In this case no physical inventory or valuation of the property is available, and neither is required by the act. However, in view of the comparatively recent date at which most of the property was acquired, and of the fact that such property appears to be reasonably necessary to the carrier's operations, the net book value affords a basis upon which to estimate the rate of return. The net book value of the real property and equipment used in the carrier's operations as of July 31, 1935, was \$230,505, and at the end of the audit period was \$200,689. A reasonable allowance should be made for working capital. On June 30, 1936, the carrier had \$75,987 cash on hand and material and supplies valued at \$21,602; but these items are not necessarily conclusive of the carrier's reasonable needs for working capital. *Atlanta, B. & A. R. Co.*, 75 I. C. C. 645.

For the period prior to March 1, 1935, the carrier recorded a substantial operating deficit, and no adjustments therein are indicated. Obviously no unreasonable profits were accrued during this period. During the first full year of operations under the rate fixed by the Commission, the carrier recorded a net income from operations of \$39,626. This, however, includes items not essentially a part of the transportation of the

mail and the services connected therewith. Excluding the profits resulting from the sale of fuel and oil, repair services performed for others, special flights, and other miscellaneous operations, and the loss incurred in connection with the Boeing plane not wholly covered by insurance, this amount is reduced to \$26,624. Using an average of the net book values of real property and equipment as of July 31, 1935, and June 30, 1936, plus a reasonable allowance for working capital, the return would be about 8.7 per cent. An examination of operations during the last 4 months of the audit period indicates that the results of operations during this period were fairly comparable with the corresponding months of 1935.

While, as heretofore pointed out, the act does not specify what shall constitute an unreasonable profit, it must be presumed that the Congress did not intend to prohibit air-mail carriers from receiving a fair return upon the value of their property. What rate of return would be fair and reasonable in the case of air carriers has not been fixed by Congress or the courts. It appears well settled, however, that the rate of return to which owners of property devoted to public service are entitled depends upon a consideration of all of the circumstances and hazards of the business. The air-transport industry is a comparatively new field of endeavor. Its operations are restricted by weather conditions and other factors, and are subject to more violent financial uncertainties than those of transportation enterprises generally. Moreover, changes in operating conditions are frequently required by Governmental regulations and the rapid development of the art of air navigation. Obviously, a somewhat higher rate of return is warranted under such circumstances than that for well established and stabilized public service industries.

We find that no unreasonable profit is accruing to or being derived by Western Air Express Corporation, from the rate of compensation being paid for the transportation of air mail by airplane on route No. 13, for the period May 8, 1934 to June 30, 1936.

By the Commission, division 3.

W. P. BARTEL,
Secretary.

(SEAL)

**INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 33**

National Airlines System, Rate Review 1935-1936

Submitted December 21, 1937

Decided March 5, 1938

Upon review of air mail rates of compensation being paid on route No. 31, no unreasonable profit found to have been derived or to be accruing therefrom for the period October 15, 1934 to June 30, 1936.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, PORTER, AND MILLER

By DIVISION 3:

No exceptions were filed to the tentative report of the examiner which was served upon the Postmaster General and National Airlines System.

This is a proceeding under paragraph (b) of section 6 of the Air Mail Act of 1934, as amended, to review the rates of compensation being paid to G. T. Baker, doing business as National Airlines System, hereinafter referred to as the carrier, for the transportation of air mail by airplane and the service connected therewith over route No. 31, between St. Petersburg and Jacksonville, Florida, to determine whether any unreasonable profit was being derived or accruing therefrom.

The route was advertised on May 5, 1934, for temporary air mail service between Daytona Beach and St. Petersburg, via Orlando, Lakeland and Tampa, Florida, a distance of 148 miles. An initial unit of 15 cubic feet of air mail space on one round trip daily, in day service, was to be furnished, and passenger and express facilities were required to be provided. In other respects the advertisement was similar to those described in *Air-Mail Compensation*, 206 I. C. C. 675.

A temporary contract for this service was executed on August 2, 1934, but operations did not begin until October 15, 1934. The temporary contract was extended from January 15 to October 14, 1935, and thereafter was indefinitely continued. D. K. Franklin and G. T. Baker, copartners doing business as National Airlines Taxi System, operated the route until March 1, 1935, since which date it has been operated by Baker. The route was temporarily extended 92 miles from Daytona Beach to Jacksonville on November 19, 1934, which extension was still effective at the close of the audit period. Beginning January 25, 1935, as a result of a resurvey by the Department of Commerce of distances flown over the route, mail pay was based upon 264 miles, of which 166 miles were between St. Petersburg and Daytona Beach and 98 miles between the latter point and Jacksonville. Effective July 1, 1935, authorized mail pay was based upon 262 miles by one course and 241 miles over an alternate course.

Section 6(b) of the original act directed us to review the rates of compensation being paid to the holder of each air mail contract, at least once in every calendar year from the date of the letting of such contract, in order to be assured that no unreasonable profit was resulting or accruing therefrom. For the purpose of complying with that direction, an audit of the books, records, and accounts and a review of the operations of the carrier from the beginning of operations under the contract to March 31, 1935, were made. The act was subsequently amended on August 14, 1935, materially adding to our duties in making these reviews. A further investigation was made pursuant to the directions of the amendments, and the period of the audit was extended to June 30, 1936.

Rates were initially fixed under section 6(a) of the act in *Air Mail Rates for Route No. 31*, 214 I. C. C. 387, the rate for the route as originally advertised being 30 cents per airplane mile, and as extended to Jacksonville 27 cents.

Investment. During the audit period the carrier had no investment in land, buildings, and improvements. Operations were started with two single-engine Ryan airplanes, and two Wasp, and one Wright, engines. The planes were recorded on the books at \$8,000 and the engines at \$4,200, but the carrier advises that the planes cost \$3,430 and the engines \$1,436. As of the date operations began the books show an investment of \$2,000 in shop equipment, aircraft communication equipment, and furniture and fixtures.

On December 11, 1934, the carrier acquired another Wright engine at

a cost of \$700. One Stinson U and one Stinson T planes and six Lycoming engines were acquired on March 23, 1935. The carrier advises that the planes cost \$2,570 and \$1,500, respectively, and the engines a total of \$2,364. The carrier purchased another Lycoming engine in August, 1935, at a cost of \$564. Another Stinson T plane and five more Lycoming engines were purchased in January, 1936, at costs said by the carrier to be \$4,500 and \$4,000, respectively. The two Ryan planes and one Wasp engine were retired in January, 1936. One of the Wright engines was retired in September, 1935, and the other in January, 1936.

All of the flying equipment used by the carrier during the audit period was purchased second hand, and the actual cost thereof cannot be ascertained from an examination of the carrier's records. The amount recorded on the books is stated by the carrier to be in excess of actual cost of the property. From the best information available it appears that the carrier's property investment at the beginning and at the end of the audit period was \$6,866 and \$23,096.90, respectively, representing actual cost, without accrued depreciation. The latter amount includes the cost of one Dodge automobile, recorded at \$688. There is nothing to indicate that the carrier paid more than the fair market value at time of purchase for any of this property. New airplanes of the types acquired by the carrier sold about the time of acquisition at approximately the following list prices: Ryan B-5 with Wright engine \$12,985, Ryan B-7 with Wasp engine \$16,985, Stinson U with Lycoming engines \$22,900, and Stinson T with Lycoming engines \$23,900.

Material and supplies were carried on the books at \$1,500 and \$8,051, respectively, at the beginning and end of the audit period. The former figure is not supported by vouchers or any other data. An inventory of material and supplies, taken as of June 30, 1936, shows \$10,660, which is \$2,609 in excess of the ledger balance, but it is not shown that the unit prices used in the inventory were those paid for the property.

Operations. The carrier began mail service on October 15, 1934, and passenger service on December 22, 1934, on one round trip daily over the route. The route is described in *Air Mail Rates for Route No. 31, supra*. The carrier had no off-line operations, no exclusive nonmail service, and no weight-credit mail service. Intermediate stops were made at Tampa, Lakeland, Orlando, and Daytona Beach.

During the period from October 15, 1934 to March 1, 1935, when the rates fixed in *Air Mail Rates for Route No. 31, supra*, were made applicable as rates of payment by section 6(c) of the act, the carrier flew 57,830 revenue airplane miles, of which 27,209 miles were in exclusive mail service. It carried 12,301 pounds of mail, an average of 36.43 pounds per mile flown in mail service, and 94 revenue passengers. Revenue passenger miles flown were 19,312, and seat miles operated were 124,608. The revenue load factor was thus 15.57 per cent, and the average number of revenue passengers carried per mile flown in passenger service was 0.63. Corresponding figures for the remainder of the audit period were: 250,832 revenue airplane miles flown, all of which were in combined mail-passenger service; 61,557 pounds of mail, an average of 49.82 pounds per mile; 1,531 revenue passengers; 325,005 revenue passenger miles; 1,884,382 seat miles operated; a load factor of 17.25 per cent; and an average of 1.32 passengers per mile.

Operating revenues. During the period October 15, 1934 to March 1, 1935, the carrier recorded operating revenues in the amount of \$11,266, of which the mail revenue, \$9,612, and the passenger revenue, \$1,276, constituted 85.32 per cent and 11.33 per cent, respectively. For the period March 1, 1935 to June 30, 1936, inclusive, operating revenues amounted to \$85,261, of which the mail revenue, \$67,673, and the passenger revenue, \$15,465, constituted 79.37 per cent and 18.14 per cent, respectively. Passenger fares averaged 6.26 cents per passenger mile during the former period and 4.76 cents during the latter period. Express and excess baggage carried were small in volume and yielded revenues of \$505 and \$34, respectively, during the audit period.

Operating expenses. The carrier's recorded operating expenses during the periods October 15, 1934 to March 1, 1935, and from March 1, 1935 to June 30, 1936, were \$13,600 and \$86,918, or 23.46 cents and 33.74 cents per mile, respectively. The bulk of the operating expenses is made up of pay rolls, fuel for engines, and charges for depreciation and self-insurance. Of the pay roll expenditures, the largest item is the pay of two pilots at \$500 each per month. The salaries paid other personnel are materially lower, and generally are less than those paid by other carriers for similar services.

Charges during the audit period for depreciation on equipment, furniture and fixtures amounted to \$4,053. Most of this amount was for depreciation on planes and engines which was estimated at 50 cents each per flight hour. Included in this amount was \$822 covering depreciation on the two planes and three engines retired from service in September, 1935 and January, 1936. The accounting for these retirements was not made until June, 1936, when \$1,328 was charged to the appropriate retirement accounts and \$8,000 was charged to the owner's account, this equipment thus being cleared from the property accounts, taking into consideration \$750 realized from the sale of one of the engines. The total charges to operating expenses on account of the depreciation and retirement of this equipment were less than the total actual cost to the carrier, but include \$241 in the retirement account for the engine sold, which had been set up on the books at \$1,000 and on which depreciation charges of \$9 had been accrued. This engine actually cost \$342.

Self-insurance to cover anticipated losses from crash, fire, tornado, and theft was provided by establishment of an insurance reserve through periodic charges to operating expense. This reserve amounted to \$7,437 for the period and was based on charges of 2.75 mills per passenger mile for passenger liability, 1.5 and 1.25 mills per airplane mile for public liability and property damage, respectively, and 28.83 per cent per annum of the cost of aircraft and engines for protection of the carrier's property investment. The charges for public protection do not appear to be higher than the usual cost of insurance covering such risks, but the charge for protection of property investment will, if continued, equal the cost of the property in approximately $3\frac{1}{2}$ years, and is a higher rate than the charge for depreciation on the same equipment. The latter charge appears to be higher than is reasonably necessary for the purpose of meeting the risk of damage to equipment. No loss from any of the risks covered by these insurance charges occurred during the audit period.

Practically all of the gasoline and oil used by the carrier was pur-

chased from one company at average prices per gallon of 17.40 cents for gasoline and 70.89 cents for oil, both inclusive of tax. As of July 1, 1935, the State of Florida removed its tax of 7 cents on aviation gasoline. The City of Jacksonville imposes a tax of 2 cents per gallon on all gasoline handled in that city. It appears from consideration of the mileage flown and gasoline used as recorded in the carrier's books that the amount of gasoline used per mile on this route is somewhat less than is usually required for the type of equipment employed. It is probable that the carrier's records do not reveal the total amount of gasoline used during the audit period.

Net income. The carrier's books show a loss of \$2,334 for the period prior to March 1, 1935, and a loss of \$1,656 for the subsequent period. These amounts represent net operating loss, net loss from operations, and net loss, there being no transactions affecting items in the income account below net operating loss. Losses were experienced during every month of the audit period except one. Charges for insurance during the later period amounted to \$6,567, most of which was to cover losses on account of flying equipment. Any adjustment of the income account in connection with this item or with the retirement of equipment previously discussed, however, would not be important in the results shown.

Expenditures. The records of the carrier's expenditures do not permit of accurate determinations in respect of purchases or rents, some recorded expenditures, for example, not being identified definitely with any property, and others, on the other hand, not showing accurately the amounts paid for property known to have been used in the operation of the route. There is reason to believe that more material and supplies, particularly gasoline, have been used than the books show.

There is nothing, however, to indicate that any expenditures made in connection with the route have been unreasonably high or that there has been collusion of any kind in connection with such expenditures. It does not appear that any purchases have been made by the carrier from any person, firm, or corporation affiliated therewith.

Conclusions. This route has been operated from the beginning with secondhand flying equipment which was purchased at very low prices. The volume of traffic carried has been small and has remained fairly constant during the audit period. It is probable that with adjustment of the charges to operating expenses for insurance and retirements the route has been operated at a small profit. While it is impossible, because of the deficiencies in the carrier's records heretofore pointed out, to make any reasonable determination from the information available of the precise amount of net income which would be reflected by such adjustments, it is obvious that it would not be sufficiently large to amount to more than a reasonable return upon the carrier's investment.

We find that no unreasonable profit was resulting or accruing to G. T. Baker, doing business as National Airlines System, from the rate of compensation being paid for the transportation of air mail by airplane and the service connected therewith on route No. 31 for the period October 15, 1934 to June 30, 1936.

By the Commission, Division 3.

(SEAL)

W. P. BARTEL,
Secretary.

INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 37

Delta Air Corporation, Rate Review 1937

Submitted January 4, 1938

Decided January 21, 1938

Upon review of air-mail rates of compensation being paid on route No. 24, no unreasonable profit found to have been derived or to be accruing therefrom to the carrier during the period April 1, 1936 to May 31, 1937.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, PORTER, AND MILLER

By DIVISION 3:

No exceptions were filed to the tentative report of the examiner, which was served upon the Postmaster General and Delta Air Corporation.

This is a proceeding under section 6(b) of the Air Mail Act of 1934, as amended, for review of the rates of compensation being paid to Delta Air Corporation holder of the contract for the transportation of air mail by airplane over Air Mail Route No. 24, between Charleston, S. C., and Dallas, Texas, in order to determine whether any unreasonable profit was being derived or accruing therefrom.

The present review is based upon an investigation which has been made as directed by section 6(b) for the period from April 1, 1936 to May 31, 1937, inclusive, hereinafter referred to as the audit period. A report of the audit of the carrier's accounts for this period was sent to the Postmaster General pursuant to the provisions of section 10 of the act, and a copy thereof was furnished to the carrier.

A like review was made while we had under consideration the carrier's petition under the provisions of section 6(a) of the act for redetermining the fair and reasonable rates of compensation for the transportation of air mail by airplane and the services connected therewith over this route. *Air Mail Rates for Route No. 24*, decided July 6, 1937, 222 I. C. C. 749. Although the record in that proceeding embraced the results of the carrier's operations through June 30, 1936, the section 6(b) review was based upon an examination and audit of the books, accounts, contracts, and entire business records for the period from July 4, 1934, the date of the beginning of mail operations over the route, to March 31, 1936, inclusive. We found that no unreasonable profit had been derived or was accruing from the rates of compensation which the carrier had received under its contract. We further found that the base rate of 28 cents per airplane mile applicable to a base of 63,000 miles per month upon which compensation was determined at the close of the period was not fair and reasonable from and after May 12, 1936, and fixed such fair and reasonable rate at 29 cents for a base mileage of 105,000 miles per month.

The carrier's corporate history was reviewed and its operations and investment described in detail in *Air Mail Rates for Route No. 24, supra*. Its dusting operations are not involved in this proceeding. The capital

stock outstanding has since been increased from \$82,340 to \$85,340. Only minor changes have occurred in the scheduled operations.¹

Investment. The carrier's recorded investment in real property and equipment in use in route operations on May 31, 1937, was \$305,481. Depreciation accruals against this property totaled \$113,876 leaving a net book value of \$191,605.

The principal additions to the carrier's property during the audit period included one Lockheed Electra plane, three Wright Whirlwind engines, and communication stations replacing the old facilities at Atlanta, Ga., and Dallas, the aggregate cost of which was \$70,537. During the same period 6 Stinson, Model T, 2 Stearman and one Stinson, Model A, planes, 29 Lycoming engines, one two-way radio, and the replaced communication station facilities recorded at an aggregate original cost of \$81,477 were retired. The carrier's flying equipment at the close of the audit period consisted of 4 Lockheed Electra, one Stinson A, and one Pitcairn planes and 12 Wright Whirlwind, 4 Lycoming and one Wright J-6-7, engines.

Results of operations. Although, as hereinbefore stated, our conclusion as to the absence of unreasonable profits contained in *Air Mail Rates for Route No. 24, supra*, was limited to the period prior to March 31, 1936, we found that, based on the evidence presented by the carrier and an audit made by representatives of the Postmaster General, a net deficit from operations of approximately \$24,000 was incurred during the first 6 months of the calendar year 1936. Adjustment of this amount to reflect the additional mail pay due the carrier for service subsequent to May 12, 1936, under the Postmaster General's order of September 15, 1937, would reduce the deficit by less than \$2,000. Consequently no unreasonable profit could have accrued to the carrier prior to the close of the fiscal year ended June 30, 1936. Further consideration of the carrier's operations prior to that date is, therefore, unnecessary.

For the remaining 11 months of the audit period, i. e., the period from July 1, 1936 to May 31, 1937, inclusive, the carrier's books record a net deficit from operations of \$13,920. Nonoperating items are not here considered. *Inter-Island Airways Rate Review, 1936, 225 I. C. C. 115.*

Recorded revenues totaled \$435,622 of which \$282,534, or 64.86 per cent, represents mail compensation and \$144,436, or 33.16 per cent, passenger revenue. The remainder included revenue from excess baggage, express, freight, fuel and oil sales and incidental services. Computation of mail compensation on the basis of the rate fixed in *Air Mail Rates for Route No. 24, supra*, would increase revenues as recorded by approximately \$14,500.

During the 11 months' period the carrier flew a total of 1,095,254 airplane miles, of which 1,005,827 were in mail-pay service. Mail was carried on a weight-credit basis on all other scheduled miles flown during the period, with the exception of one trip from Atlanta to Birmingham which was flown in exclusive passenger service during the last 15 days of the period. The average mail load, including weight-credit service, was 84.76 pounds per airplane mile. During the period 10,344 revenue passengers

1. Effective September 18, 1936, the frequency of one authorized mail-pay schedule between Atlanta, Ga., and Dallas was changed from daily except Mondays and days after holidays to daily except Sundays and holidays. Effective May 17, 1937, the weight-credit authorization on a one-way trip from Atlanta to Birmingham, Ala., was canceled.

were carried 3,116,883 revenue passenger miles. No off-line service was operated.

Operating expenses for the 11 months' period as recorded aggregated \$444,201, or 40.56 cents per mile flown. Of this amount \$64,801, or 14.59 per cent, represented charges for depreciation, and \$48,078, or 10.82 per cent, charges for repairs of aircraft and engines. The depreciation reserve was accrued through monthly charges computed on the straight-line method of depreciation based on service lives of 3 years for Stinson A and 4 years for Electra planes, and 3,000 flying hours for both Wright and Lycoming engines. The expenses incident to repairs of flying equipment were charged as incurred, and totaled \$23,054, or 2.10 cents per mile flown, for aircraft, and \$25,024, or 2.28 cents per mile flown, for engines.

With the exception of salaries, the cost of fuel for engines was the largest single item of expense incurred. The total expense thereof was \$60,121, reflecting the use of 369,569 gallons at an average cost of 16.27 cents per gallon, or 5.49 cents per mile flown.

The total pay roll expense for the 11 months' period aggregated \$188,396. During a representative month, February, 1937, this expense was \$17,047, distributed \$767 to administration; \$1,053 to general offices; \$6,900 to operations; \$1,031 to traffic, and \$7,296 to flying personnel. The latter amount was based on the scale of wages promulgated by the National Labor Relations Board. At the close of the period the carrier employed 115 persons in its airline operations, three of whom were part-time employees.

Insurance costs totaled \$46,664, of which \$45,444 was charged to conducting transportation, \$1,198 to maintenance, and \$23 to general and administrative expense. Of the expense charged to conducting transportation \$32,390 represented aircraft, \$11,684 passenger, and \$1,370 flying personnel insurance.

Interlocking relations. Only three of the carrier's stockholders held in excess of 5 per cent of its outstanding capital stock. None of the purchases of supplies, services, or rentals was made for any vendor or lessor in whom the carrier, its major stockholders or its officer or employees had any interest; nor were any such purchases made or rentals paid from which any of the employees or stockholders appear to have benefited, either directly or indirectly.

Expenditures. During the audit period the carrier purchased goods and commodities and incurred liabilities for services at prices which appear to have been reasonable in comparison with prevailing prices as shown in price lists, catalogs, and specifications of manufacturers and distributors. However, lack of sufficient cash working capital has handicapped the carrier in the development of its purchasing policies and in certain instances has resulted in failure to obtain maximum trade discounts.

Salaries, fuel costs, and insurance premiums, previously discussed, represented the largest single item of expenditure. Flying equipment purchased during the audit period included one Lockheed Electra equipped with two Wright Whirlwind engines and a Pitcairn Mailwing. The Electra was purchased from the manufacturer equipped, at a total cost of \$46,453, f.a.f.² El Paso, and the Pitcairn was acquired second-hand for \$600. An additional Wright engine was purchased from the manufacturer at a cost of \$4,318.

2. "Fly away field," i. e., delivered at the airport ready for flight.

Conclusion. As hereinbefore shown, the carrier's books recorded a net deficit from operations of \$13,920 during the 11 months' period under consideration. This deficit would be increased to \$15,013 if profits from the sale of fuel and repairs to aircraft of others were eliminated. As reviewed, operations appear to have been conducted efficiently and economically, operating expenses averaging over one per cent per mile less than the expenses during the preceding 6 months as developed at the hearing in *Air Mail Rates for Route No. 24, supra*. Furthermore, there is no indication that the books failed correctly to reflect the results of the carrier's operations. Adjustment of mail compensation in accordance with the applicable rate would still leave a net deficit of approximately \$500 for the period. Exclusive passenger operations represented such a minor item that their effect on the net result of all operations for the period would be negligible.

We find that no unreasonable profit was resulting or accruing to Delta Air Corporation from the rate of compensation being paid under its contract for the transportation of air mail by airplane on route No. 24 during the period April 1, 1936 to May 31, 1937.

By the Commission, division 3.

W. P. BARTEL,
Secretary.

(SEAL)

INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 39

Hanford Airlines, Inc.,-Hanfords Tri-State Airlines, Inc.,
Rate Review 1934-1937

Submitted May 19, 1938

Decided June 14, 1938

Upon review of air-mail rates of compensation on routes Nos. 16 and 26 no unreasonable profit found to have been derived or accrued for the period June 1, 1934 to June 30, 1937.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, MAHAFFIE, AND MILLER

BY DIVISION 3:

No exceptions were filed to the tentative reports of the examiner, the first of which covered the period from beginning of operations to March 31, 1937, and the supplemental report, the period from April 1 to June 30, 1937. The reports have been consolidated.

This is a proceeding under section 6(b) of the Air Mail Act of 1934, as amended, for review of the rates of compensation being paid to Hanford Airlines, Inc., the present holder of the contract for the transportation of air mail by airplane over route No. 26 between Minneapolis, Minn., and Tulsa, Okla. (originally between St. Paul, Minn., and Kansas City, Mo.), and between Huron, S. Dak., and Bismarck-Mandan, N. Dak., in order to determine whether any unreasonable profit was being derived or accruing therefrom. The reviewer also covers the prior operations of route No. 26, and of

route No. 16 between Chicago, Ill., and Pembina, N. Dak., by predecessor companies.

Audits and investigations in the particulars directed by section 6(b) were made for the periods from the beginning of operations¹ to June 30, 1937, on route No. 26, and to December 31, 1934, on route No. 16, except that the audit for route No. 26 does not cover the period from April 1 to June 30, 1936. The initial audit for the latter route covered operations from the beginning of mail service to March 31, 1936. Subsequently the records of the contractor, Hanfords Tri-State Airlines, Inc., were destroyed by fire, so that no audit could be made for the period from April 1 to June 30, 1936, when Hanford Airlines took over the operation of the route. To overcome this deficiency to the extent deemed necessary for the purposes of this proceeding the audit report has been supplemented by the record of operations taken from the carrier's annual report to the Postmaster General for the year ended June 30, 1936. Reports of the audits were sent to the Postmaster General pursuant to the provisions of section 10 of the act, and copies thereof were furnished to Hanford Airlines.

Contracts for the carriage of air mail by airplane were made by the Postmaster General on route No. 16 with Hanfords Tri-State Airlines, Incorporated, for a bid rate of 19.6 cents,² and on route No. 26 with its successor, Hanfords Tri-State Airlines, Inc., for a bid rate of 18.9 cents. These contracts were originally for a period of 3 months but were later extended for 9 months and thereafter indefinitely continued. In addition to space for mail the carriers were required to furnish passenger and express facilities. The Postmaster General subsequently approved transfer of the air-mail contract on route No. 16 to Northwest Airlines, Inc., effective January 1, 1935, and of the air-mail contract on route No. 26 to Hanford Airlines, effective July 1, 1936. In its initial investigation under section 6(a) of the act the Commission fixed rates of 25 cents for a base of 45,000 miles per month on route No. 16, and 32 cents for a base of 50,000 miles per month on route No. 26.³ The amendatory act of August 14, 1935, made these rates applicable as rates of payment from March 1, 1935.

Capitalization and investment. Hanford Airlines was incorporated under the laws of Delaware on May 6, 1936, with an authorized capital stock of 400,000 shares of \$1 per value, of which 168,137 shares were issued to Hanfords Tri-State Airlines, Inc., in purchase of its properties, including the air-mail contract on route No. 26. The latter company, a Delaware corporation, was organized July 2, 1934, and was the successor under reorganization of Hanfords Tri-State Airlines, Incorporated, an Iowa corporation, acquiring all of the latter's physical property and the air-mail contract on route No. 16. An additional 225,000 shares were issued by Hanford Airlines at par for cash during the audit period. Of the stock outstanding on June 30, 1937, 56.85 per cent was held by the executive vice-president of Hanford Airlines and 42.77 by the Delaware corporation. Of the stock held by the latter, 74.14 per cent was for account of the president of Hanford Airlines, and 16.06 and 9.80 per cent for two other stockholders, respectively. No dividends have been paid on any of the stock issues.

1. Mail operations began July 3, 1934, on route No. 26 and June 1, 1934, on route no. 16.

2. Rates are stated in cents per airplane mile.

3. The rates were subject to increases or decreases accordingly as the monthly mileage flown decreased or increased more than 10 per cent of the base mileage.

The properties of the Iowa corporation which were taken over by the Delaware corporation consisted of various assets amounting to \$306,203 and liabilities of \$61,083, including accrued depreciation of \$37,177,—a net book value of \$245,120. Other liabilities consisting of \$332,889 of long term debt held or controlled largely by the president of the Iowa corporation were not assumed. Payment for the properties was made through an issue of 13,800 shares of stock of \$25 par value, amounting to \$345,000. Assets and liabilities were recorded by the Delaware corporation on its books at the amounts at which they had been taken over from the Iowa corporation. The difference between the net book value of the properties and the amount of capital stock issued in payment thereof was accounted for by a charge of \$100,000 as goodwill, representing pioneering cost of the air mail routes, and a credit to profit and loss of \$120.

On March 31, 1936, the Delaware corporation's recorded investment in real property and equipment was \$241,403 and in miscellaneous physical property, \$13,474, with accrued depreciation of \$78,161. Current and accrued assets were \$74,701 and liabilities, \$121,956, with goodwill of \$100,000 and prepayments of \$2,208. Operating, insurance, and other reserves were \$16,929. The mail contract for route No. 16 was sold to Northwest Airlines for \$48,000, represented by 12 notes of \$4,000 each, maturing serially. These notes were discounted for \$46,737 and the proceeds credited to profit and loss. No physical property was transferred under the sale. The annual report to the Postmaster General for the fiscal year ended June 30, 1936, shows a recorded investment in real property and equipment of \$242,466 and in miscellaneous physical property of \$13,483, with accrued depreciation of \$88,374. Operating reserves had been reduced to \$8,914. The only other material change was in current liabilities which on that date amounted to \$116,113.

Flying units acquired by the Delaware corporation from its predecessor consisted of 13 planes and 24 engines, having a net book value of \$96,263. This equipment, comprising a miscellany of types and kinds, including single engine, twin engine, and tri-motored planes, was manufactured on various dates in 1929, 1930, and 1931. Through additions and retirements the carrier at the end of March, 1936, had in use 9 planes and 25 engines, having a recorded net book value of \$49,305.

Hanford Airlines commenced its operation of route No. 26 with a recorded investment in real property and equipment of \$61,243, representing the depreciated book value of property taken over from the Delaware corporation; one share of Aeronautical Radio stock, \$10; current and accrued assets, exclusive of cash, \$9,740, consisting chiefly of materials and supplies; prepayments, \$269, and goodwill of \$100,000 as pioneering cost on route No. 26. In addition to these items covering assets purchased from the Delaware corporation, cash of \$175,000, representing sale of stock at par, was recorded. The only liabilities of the former company assumed by Hanford Airlines were for accounts and wages payable amounting to \$3,126. Recorded capital stock liability was \$343,137.

Recorded investment in real property and equipment at the end of the 1937 fiscal year was \$225,310,⁴ with accrued depreciation of \$49,109.⁵ Cur-

4. There is included an item of \$682 for the cost of replacement of nose cowl on plane, which was properly chargeable to operating expense. An amount of \$116 for pilot's salary in delivery of new plane was charged to

rent and accrued assets were \$108,887⁶ and liabilities were \$98,399, the latter consisting chiefly of three notes maturing serially by months for an aggregate of \$18,175, balance of purchase price on a new Electra plane, and a 6-month note of \$50,000 due November 1, 1937, the proceeds of which were to supply working capital. Operating and insurance reserves were \$5,955. Goodwill had been increased to \$150,000 and capital surplus credited with \$50,000. Prepayments amounted to \$3,242. Deferred debits included \$3,206 remaining from expenses incurred in the organization of the carrier which were being amortized through operating expenses. A profit and loss debit balance of \$105,944 was shown. To provide additional working capital 50,000 shares of capital stock were issued at par for cash, making the capital stock liability \$393,137 on June 30, 1937.

Planes and engines taken over from the Delaware corporation consisted of two-trimotored Fords, four Lockheed Vegas, and 13 Wasp engines, having an aggregate net book value of \$22,710. Ten additional Wasps and one Jacobs engine were acquired, together with three Lockheed Electras, two new and the other second-hand, and one Waco plane with engine for which Hanford Airlines traded in part payment a similar Waco plane and engine purchased from its vice-president. Of the equipment taken over from the Delaware corporation, the two Fords and one of the Vega planes and eight of the Wasp engines were retired. At the end of the audit period Hanford Airlines had on hand three Vega planes and five Wasp engines taken over from the Delaware corporation and in addition three Electras, the Waco plane used as a training ship, and the 11 engines purchased by it, representing a net book value of \$130,645.

Operations. During the period of operation of route No. 16 two round-trip schedules daily in mail and passenger service were maintained, one each between Chicago and Pembina, N. Dak., and between Chicago and St. Paul, Minn. Off-line service was operated between Pembina and Winnipeg, Manitoba, Canada.

On route No. 26 service between July 3, 1934 and August 31, 1934, consisted of three round-trip schedules daily in mail and passenger service, one each between St. Paul and Omaha; between Omaha and Kansas City; and between Bismarck-Mandan and Sioux Falls, S. Dak. Effective September 1, 1934, an additional round-trip schedule daily for mail and passengers was authorized by the Postmaster General between Omaha and Kansas City.⁷ Effective September 1, 1936, the St. Paul-Omaha schedule was changed to a daily round trip between Minneapolis and Kansas City;

operating expense which amount was part of the cost of the plane and should have been charged to the investment account.

5. Accrued depreciation was \$29,046 on planes and \$12,042 on engines, leaving net book values of \$95,352 and \$35,293 respectively.

6. Including cash, \$42,448; materials and supplies, \$24,888, and special deposits, principally bonds deposited with the Postmaster General, \$11,838.

7. An agreement between the Delaware corporation and Rapid Air Lines Corporation, copy of which was filed with the Postmaster General, provided that Rapid Air Lines was to perform the mail service under the contract for the portion of the route between Omaha and Kansas City, to provide the equipment, and to bear the expenses of operation. Prior to the award of the mail contract the route had been operated under such an arrangement. Because of the Postmaster General's requirement of multimotored equipment between Omaha and Kansas City, the Rapid Air Lines was to be paid by the Delaware corporation one and one-third times the mail rate and was to retain passenger and incidental revenues. The amount actually paid by the Delaware corporation totaled \$20,465, based upon 24.7 cents per mile, except that for the additional schedule established in September, 1934, payments were based on the mail rate of 18.9 cents per mile. Actual operations by Rapid Air Lines began July 20, 1934, and were discontinued by it on January 16, 1935.

one of the two schedules between Omaha and Kansas City was discontinued and the other became a weight-credit trip. A mail-passenger schedule was established daily between Kansas City and Tulsa which was operated on Sundays and holidays in weight-credit service. On May 17, 1937, an additional weight-credit mail schedule daily between Minneapolis and Tulsa was inaugurated. Effective February 5, 1937, the Bismarck-Mandan-Sioux Falls schedule was changed to a round-trip daily between Bismarck-Mandan and Huron, connecting at that point instead of Sioux Falls with the schedules between Minneapolis and Kansas City. No exclusive passenger schedule other than the off-line service to Winnipeg was operated.

Revenues, expenses, and income. Operations of the Iowa corporation for the month of June, 1934, resulted in a recorded net deficit on route No. 16 of \$2,376. Operating revenues were \$16,164; operating expenses, \$18,300; and net deficit from operations, \$2,211. Non-operating items accounted for the difference between the deficit from operations and the net deficit.

For the period from July 1, 1934 to June 30, 1935, operations of the Delaware corporation resulted in a recorded net deficit of \$186,668, of which \$118,842 accrued on route No. 26 and \$67,825 on route No. 16. Recorded net deficit from operations was \$67,903 on route No. 16 and \$118,138 on route No. 26. There are included on route No. 26 uncollectible items of \$330 applicable to the period prior to the mail contract. For the fiscal year ended June 30, 1936, the net deficit from operations on route No. 26 reported to the Postmaster General was \$21,430. Nonoperating income and deductions from gross income increased the deficit to \$24,227.

Recorded revenues and expenses of the Delaware corporation for the fiscal year ended June 30, 1935, were \$90,227 and \$157,880, respectively, on route No. 16 and \$151,115 and \$268,177, respectively, on route No. 26. For the year ended June 30, 1936, revenues on route No. 26 were \$283,700 and expenses were \$304,129. The separation of revenues and expenses between the routes for the period from July 1 to December 31, 1934, inclusive, was made on the basis of miles flown. Revenues of the Delaware corporation on route No. 26, however, do not include \$30,442 representing back mail pay to the basis of the rates found reasonable by the Commission and made applicable by the amendatory act. The carrier credited such revenue to profit and loss. Other adjustments indicated to be proper for that route relate to operating expenses and include \$1,637, duplication of salaries, adjusted through profit and loss instead of operating expenses; \$5,913 for unpaid salaries which were subsequently canceled and credited to profit and loss; and \$500 for salaries charged to profit and loss rather than operating expenses. These adjustments would result in a net deficit from operations on route No. 26 of \$101,745, which, with the deficit from operations of \$67,903 on route No. 16, would give an adjusted total deficit for the Delaware corporation of \$169,649.

Certain additional adjustments of operating expenses are indicated by reason of other items recorded as profit and loss. No allocation of these items as between the two routes was made by the carrier. Such adjustments would not exceed, approximately, credits of \$4,500 and charges of \$5,500. The Delaware corporation also recorded as profit and loss the net proceeds amounting approximately to \$4,000 from sale of equipment. It is apparent, however, that the net result of the Delaware corporation's

operations would not be affected materially by reason of these adjustments.

The Delaware corporation advanced various amounts of money to its first president, which were recorded as accounts receivable although a portion thereof was for traveling and other expenses incurred in behalf of the carrier. Repayments resulted in a recorded net amount due the carrier on June 30, 1935, of \$11,727. Since no salary had been paid to that officer, the carrier charged the net balance due to salaries and expenses of general and administrative officers by retroactive journal entries for each month of the fiscal year ended June 30, 1935.

Cost to the Delaware corporation of conducting transportation during the audit period was \$69,919 on route No. 16 and \$250,543 on route No. 26, representing 44.28 and 49.95 per cent, respectively, of the total operating expenses. Of the total cost of conducting transportation, salaries and expenses of flying personnel accounted for 36.26 per cent on route No. 16 and 28.49 per cent on route No. 26,⁸ while gasoline and oil represented 29.78 per cent on route No. 16 and 28.14 per cent on route No. 26. The largest of the remaining items of expense in this group was for rents of fields and other property on route No. 26 which amounted to \$43,407, equal to 17.33 per cent of the total.⁹ An examination of the carrier's records showed expenditures for gasoline, oil, and grease of \$103,921 and for leases and rentals of \$27,185. The average cost of the gasoline, including Federal and State taxes, and handling and freight charges was 12.3 cents per gallon. Prices for lubricating oil ranged from 40 to 54 cents per gallon. The principal items composing the rental charge were for hangar-passenger station building and gasoline facilities at Kansas City, \$350 per month, and hangar at Omaha and field and hangar at Sioux Falls for \$225 and \$300 per month, respectively. Under an arrangement with the United Air Lines Corporation that carrier furnished ticket service and passenger accommodations at Omaha for a monthly rental of \$150. Ticket and dispatching services were furnished by Northwest Airlines at Minneapolis and St. Paul for \$180 per month. Joint or consolidated ticket offices were maintained with other air line operators at Kansas City and Minneapolis.

A reserve for overhaul of flying equipment was accumulated by the Delaware corporation by means of monthly charges to operating expenses based originally upon a rate of \$2 per flight hour on planes and \$1.50 on engines. Subsequently the monthly charge for both planes and engines was reduced to 50 cents per hour. The balance in the operating reserves on March 31, 1936, totaled \$16,429, including reserves accumulated for special audit expense and inventory adjustments amounting to \$990. On June 30, 1936, the reserves amounted to \$8,914. The carrier also maintained a reserve of \$500 for bad debts.

Charges for depreciation and retirements by the Delaware corporation were \$25,349 on route No. 16 and \$47,378 on route No. 26, equivalent to 16.05 and 9.44 per cent, respectively, of total operating expenses. Depreciation charges were based upon 6,000 flying hours for planes and 3,000 hours for engines. The bases on other property varied prior to January 1, 1936, when the carrier assigned a service life of 10 years for communication equipment; 16 years for the hangar at Stevens, S. Dak., and with a few ex-

8. Beginning in September, 1934, flying personnel was paid on basis of the wage scale fixed by the National Labor Board.

9. This included the payment to Rapid Air Lines.

ceptions, 10 years' service life on the remainder. No allowance was made in any instance for salvage value.

Hanford Airlines recorded operating revenues of \$308,311 and expenses of \$411,097 for its operations from July 1, 1936 to June 30, 1937. Taxes assignable to operations were \$4,055 and uncollectable revenues \$179, resulting in a net deficit from operations of \$107,020.¹⁰ Nonoperating income and deductions produce a net deficit of \$106,660. Profit and loss items resulting from the sale of equipment reduced and recorded net deficit to \$105,944. Taxes accrued included amounts for social security, old age benefit, unemployment and personal taxes. The balance in the reserve on June 30, 1937, amounted to \$2,816. Operating reserves were \$5,955. While the Uniform System of Accounts prescribed by the Postmaster General required operating reserves to be cleared annually, except for certain specified reasons, it is apparent that the deficit from operations would not be affected materially if operating expenses were credited with the balance in the reserves.

Mail revenues amounted to \$220,139 and constituted 71.40 per cent of the total. Passenger revenues, including receipts from baggage, amounted to \$81,676, equivalent to 26.49 per cent of the total.¹¹ Revenues from express, freight, and incidental services comprised the remainder.

Of the total recorded operating expenses of Hanford Airlines, 30.21 per cent was incurred for maintenance, 50.23 per cent for conducting transportation, 10.78 per cent for traffic and advertising, .06 per cent for miscellaneous operations, and 8.72 per cent for general and administrative expenses. The principal items of expense for maintenance covered depreciation and repairs. Depreciation charges amounted to \$52,781, made up of depreciation on aircraft, \$30,535; engines, \$13,490; airway and aircraft communication equipment, \$6,130; and all other depreciable property, \$2,625. Planes acquired from the Delaware corporation were assigned an additional service life of 2 years, while the engines were depreciated on basis of a further service life of 3,500 hours at \$1.25 per hour. Of the three Lockheed Electras, the two purchased new were given 4 years, and the one acquired from Northwest Airlines, which at that time had been in use 2½ years, was given an additional service life of 2 years. The Waco plane used as a training ship was depreciated on basis of 21 months' use, and its engine at a rate of 60 cents per hour with a service life of 2,400 hours. The Wasp engines bought during the audit period were depreciated at a rate of \$1.18, based on 4,000 hours of service. Communication equipment, including that acquired from the Delaware corporation, was depreciated on basis of a service life of 4 years. Service lives assigned to other property were: Buildings and improvements on land not owned, hangar and shop equipment, fuel, water, oil, and gas storage and distribution equipment, and furniture and fixtures, 10 years; motorized vehicles, 3 years; improvements to build-

10. Adjustments of expenses and capital accounts to include items heretofore pointed out would produce expenses of \$411,603 and deficit of \$107,526 from operations.

11. Mileage flown in mail-passenger service was 703,432 and in weight-credit service 169,881. The increase in weight-credit service in the last 3 months of the audit period was very substantial, representing approximately 50 per cent of mail-pay service. Revenue passengers transported were 6,704, representing 1,631,929 revenue passenger miles. Seat miles operated were 7,664,730 with a revenue load factor of 21.29 per cent. The highest revenue load factor was 32.55 in July, 1936, and the lowest 9.83 in January, 1937. Revenue per passenger mile was 5 cents.

ings not owned and other equipment, 5 years. No allowance was made in any instance for salvage or residual value, although two planes were sold for \$1,748 in excess of their net book value. Other equipment was sold at amounts aggregating \$1,053 less than the net book value. Charges for repairs of flying units and communication equipment totaled \$52,814 including amounts accrued for a reserve for major overhauls.¹² At the end of the audit period there was a balance in the reserve of \$3,990. The carrier also by means of a monthly charge of \$50 maintains a reserve for audit expenses, as well as a reserve for inventory adjustment due to obsolescence of supplies, based upon 7 per cent of the cost. As of June 30, 1937, these reserves were \$550 and \$1,415, respectively.

The largest portion of expense in connection with the conduct of transportation was for salaries of flying personnel, airport and hangar employees, and airway communication operators and assistants, totaling \$88,988. Wages of flying personnel have been based upon the National Labor Board scale.

Expense for gasoline used in flying operations amounted to \$43,119, equivalent to 4.54 cents per airplane mile flown. The average price per gallon was 16.2 cents, including freight, taxes, State inspection fee, and in some cases a handling charge.¹³ Oil was purchased at a contract price of 40 or 42 cents per gallon plus Federal tax of 4 cents. A small quantity of emergency purchases increased the average cost of 47.9 cents per gallon.

Insurance charged to the conduct of transportation amounted to \$22,241, equivalent to 2.34 cents per airplane mile flown. Other insurance in connection with maintenance and general and administrative expenses totaled \$3,643. The largest portion of the insurance expense was incurred for crash, fire, theft, tornado, hull, and land damage. Insurance for passenger liability and for public liability and property damage was based upon rates of 0.2 cent per passenger mile and 0.16 cent per airplane mile, respectively. Other insurance covered airport liability, hangars, buildings and contents, automobile liability, and burglary insurance.

Expense for traffic and advertising amounted to \$44,317, of which \$24,829 was expended for advertising and outside agencies. The latter amount represented 30.39 per cent of the total passenger revenue.¹⁴

General and administrative expenses on Hanford Airlines were \$35,865. The principal items were for salaries and expenses of general officers and general office employees, including amounts incurred in connection with the moving of offices from Sioux City, Iowa, to Kansas City, which aggregated \$27,878. Other expenses in this group were nominal.

The total pay roll of Hanford Airlines for June, 1937, was \$18,767. This, however, includes \$550 representing increase from \$450 to \$500 per month in the salary paid the general manager which was made retroactive to July 1, 1936. Only two of the general officers, a vice-president, who also served as general manager, and the secretary-treasurer, received salaries during the full audit period. Amounts paid them for regular salary

12. The reserve was created by charges ranging from 50 cents to \$1 per hour of flying for the different planes and from 80 cents to \$1.75 per hour on the engines.

13. State taxes were refunded except in Nebraska and in South Dakota where one-half of a 4-cent tax was refunded. Handling charges were 0.75 cents per gallon in South Dakota and 1 cent in North Dakota.

14. The carrier has numerous trade agreements under which it furnishes transportation in exchange for advertising. As of June 30, 1937, it had received advertising to a value of \$5,137 and transportation having a cash value of \$2,072 had been issued.

aggregated \$725 for June, 1937. The executive vice-president was paid a salary of \$500 per month beginning in April, 1937. In June, 1937, 10 pilots received an average salary of \$581, and 7 copilots an average of \$179. A superintendent of traffic, a chief dispatcher, and a superintendent and two assistant superintendents of maintenance received salaries ranging from \$200 to \$250. During the latter part of the audit period a chief of flight operations was employed at a monthly salary of \$450 and a chief dispatcher at Kansas City at \$400, together with three solicitors of traffic, two at \$145 each and one at \$170.

Interlocking relations. Hanford Airlines at first rented and later purchased from its vice-president a Waco training plane equipped with Jacobs engine. The rental paid was at the rate of \$6 per hour and aggregated \$123. The manufacturer's list price of the plane and engine was approximately \$5,500. The price paid by Hanford Airlines was \$3,500. Hanford Airlines also leased from the Delaware corporation a landing field, hangar, and passenger station at Sioux City for a monthly rental of \$225. The hangar was destroyed by fire and in February, 1937, the rental was reduced to \$125 per month. The carrier leased a hangar at Omaha from the Rapid Air Lines, for a monthly rental of \$120 which was increased in November, 1936, to \$175. One of the directors of Hanford Airlines has an interest in Rapid Air Lines and the latter is a stockholder in the Delaware corporation. Two employees also are minor stockholders in two of the carrier's vendors. With these exceptions and a small amount paid to the Delaware corporation for rent of a plane and engine in September, 1936, no other purchases or rentals were made from vendors or lessors, in whom the employees, officers, or stockholders of Hanford Airlines appear to have had any interest; nor were any other purchases made or rentals paid from which the employees, officers, or stockholders of Hanford Airlines appear to have benefited, either directly or indirectly.

Expenditures. The records of the Iowa and Delaware corporations were not maintained in a manner to permit a satisfactory examination of their expenditures. Such investigation as could be made indicated that purchases of maintenance materials and supplies were largely local or emergency, and needs were not anticipated to an extent that would allow quantity buying direct from the manufacturers. No invoices were preserved covering purchase of complete airplanes or engines. Generally, airplane and engine parts were bought from manufacturers at the usual operator's discount or from other airlines. Expenditures for gasoline, oil, and insurance have heretofore been discussed.

The principal expenditure of Hanford Airlines outside of its pay roll was for the three airplanes purchased, the two new ones for \$48,075 and \$41,403, respectively, including cost of radio installation and certain changes, and the second-hand one for \$25,000, complete with engines. Additional engines purchased totaled \$26,167, including two at a net price of \$4,434 each, three with an average price of \$4,389, and one with 60 hours of expired flying time for \$4,132. Airplane, engine, and propeller parts were purchased generally at discounts. Expenditures for communication equipment amounted to \$15,128. Other important expenditures have been discussed in connection with operating expenses. Payments by Hanford Airlines were made usually in time to secure cash discounts.

Conclusion. Operations on routes Nos. 16 and 26 for the periods under

review have resulted in large deficits¹⁵ which would not be materially reduced by the adjustments herein indicated as proper. On the contrary, the deficits would be greater if the net proceeds from miscellaneous operations were eliminated. No scheduled exclusive passenger service was maintained on-line during the audit period, and the off-line service to Winnipeg was performed only during the brief period of operation of route No. 16.

We find that during the operation of route No. 16 by Hanfords Tri-State Airlines, Incorporated, between June 1, 1934 and June 30, 1934, of routes Nos. 16 and 26 by Hanfords Tri-State Airlines, Inc., from July 1, 1934 to June 30, 1936, no unreasonable profit was derived or accrued from the rates of compensation for the transportation of air mail by airplane over these routes.

By the Commission, Division 3.

W. P. BARTEL,
Secretary.

(SEAL)

**INTERSTATE COMMERCE COMMISSION: AIR MAIL
DOCKET NO. 46**

Pennsylvania-Central Airlines Corporation Air Mail Bid

Decided June 3, 1938

Direction given pursuant to section 3(e) of the Air Mail Act of 1934 in respect of the single bid of Pennsylvania-Central Airlines Corporation for the transportation of air mail by airplane over a proposed route between Detroit and Sault Sainte Marie, Mich.

REPORT OF THE COMMISSION

DIVISION 3, COMMISSIONERS McMANAMY, MAHAFFIE, AND MILLER

BY DIVISION 3:

Under date of May 26, 1938, the Postmaster General submitted for our "direction" under section 3(e) of the Air Mail Act of 1934, as amended, the single bid of Pennsylvania-Central Airlines Corporation for transporting air mail by airplane over a new air mail route between Detroit and Sault Sainte Marie, Mich.

In response to the Postmaster General's advertisement of April 5, 1938, for service on this route two bids were received, but one¹ was held by the Acting Solicitor of the Post Office Department to be not in legal form and was rejected by the Department, leaving only the one legal bid here considered. Announcement to this effect, and of the submission of the one bid to us, were made public by the Department in the form of a press release.

The advertisement called for sealed proposals for the transportation of air mail on the secondary route described below, on such schedules and under such regulations as may be prescribed by the Postmaster General:

15. Recorded deficits from operations were: Iowa corporation, \$2,211; Delaware corporation, \$67,903 on route no. 16 and \$118,138 on route no. 26; Hanford Airlines, \$107,020.

1. The bid of 28½ cents per airplane mile filed by A. Stuart Weeks, of Port Huron, Mich.

Detroit, Mich., to Sault Sainte Marie, Mich., via Flint, Saginaw-Bay City and Cheboygan, Mich., and such other intermediate points as may be designated later by the Postmaster General, a distance of approximately 310 miles.

One round trip daily, except Sundays and holidays, will be authorized, but this frequency is subject to such change as the Post Office Department may deem necessary. Both day and night service may be required.

Section 3(e) of the Air Mail Act of June 12, 1934, as amended, reads as follows:

If on any route only one bid is received, or if the bids received appear to the Postmaster General to be excessive, he shall either reject them or submit the same to the Interstate Commerce Commission for its direction in the premises before awarding the contract.

Like submissions of single bids were considered in *Inter-Island Airways Air Mail Bid*, 203 I. C. C. 772, and *Transcontinental & Western Air Mail Bid*, 223 I. C. C. 281. Section 3(e) does not make formal hearing prerequisite to our action and none was held on previous submissions. No request for hearing or other presentation of facts or views in respect of this bid has been received. The Postmaster General states that the department "has determined that the bidding company is financially responsible and is otherwise a qualified and acceptable bidder" and that the "Department desires to inaugurate the service." He also submitted the following documents for our consideration:

1. Copy of advertisement for air mail service.
2. Copy of proposal of Pennsylvania-Central Airlines Corporation, by C. Bedell Monro, President, dated April 30th, 1938.
3. Bond executed by United States Casualty Company.
4. Affidavit of qualification of bidder.
5. Affidavit as to officers and directors of bidder.
6. List of officers and directors of bidder.
7. List of stockholders, holding more than 5%.
8. Letter as to ability of bidder to meet requirements of Department of Commerce, with reference to letters of authority.
9. Certificate of postmaster as to bidder.
10. Certificate of election of officers.
11. Certified copy of resolutions of Board of Directors conferring authority on President to sign bid.
12. Certificate of authority for Secretary to sign affidavits.
13. Appendix A—list of equipment.
14. Special airline equipment.
15. Certificate of Treasurer.
16. Balance sheet.

Pennsylvania Central now holds contracts for three other secondary air-mail routes. Since October 31, 1936, it has operated air mail route No. 14, between Washington, D. C., and Detroit, via Pittsburgh, Pa., and Akron and Cleveland, Ohio. On April 1, 1938, that route was extended to Norfolk, Va., and operations over the extension were begun April 7, 1938. The

base rate fixed by the Commission for this route is 33-1/3 cents per airplane mile, with a base mileage of 80,000, subject to the scaling provisions of the order of March 11, 1935, as amended June 14, 1937. It has also been operating since October 31, 1936, air mail route No. 32, between Detroit and Milwaukee, Wis., via Lansing, Grand Rapids, and Muskegon, Mich. The present rate fixed by the Commission for the latter route is 33-1/3 cents per airplane mile with a base mileage of 15,500, also subject to the order referred to above. Under date of January 14, 1937, the carrier was permitted by the Department to serve Flint, Mich., on route No. 32, "for supply." As low bidder the carrier was awarded the contract on air mail route No. 34, between Washington and Buffalo, N. Y., via Baltimore, Md., and Harrisburg and Williamsport, Pa., and operations were commenced on October 26, 1937. The rate bid and accepted for this route was eight one-hundred thousands of one cent per airplane mile. In the case of this latter route it is apparent that the carrier was willing to sustain the loss inevitable under the bid rate in order to obtain exclusive operating rights over this route. In addition to these air-mail routes it commenced carrying passengers and express between Pittsburgh and Charleston, W. Va., via Parkersburg, W. Va., on April 8, 1937, with the approval of the Postmaster General, and on March 15, and March 24, 1938, commenced carrying passengers and express between Pittsburgh and Buffalo, and between Pittsburgh and Baltimore, respectively, also with the Postmaster General's approval.

The equipment proposed to be used on the new route consists of 12 Boeing 247-D's manufactured in 1933, which have capacities in excess of those required by the advertisement. These are the same planes now in use in the operation of air mail routes Nos. 14, 32, and 34, and the passenger and express services described above, as shown by the carrier's monthly report for the month of March, 1938, with the exception that one additional plane of the same type is shown as available for use on the new route.

The bidder proposes to carry air mail, including mail equipment, over the route described at a rate of 33-1/3 cents per airplane mile for a load of 300 pounds, or fraction thereof, plus one-tenth of such rate for each additional 100 pounds of mail or fraction thereof, computed at the end of each calendar month on the basis of the average mail load carried per mile over the route during such month, except that in no case shall payment exceed 40 cents per airplane mile. The bid rate is within the maximum limit fixed by the Act.

Considering the territory covered by the proposed route, the amount of passenger and express traffic which may be reasonably anticipated, and the rates fixed for routes Nos. 14 and 32, now operated by the bidder, it does not appear from the facts before us that such bid is excessive, nor is there a suggestion from any source that it will be excessive.

The balance sheet submitted by the bidder with this proposal shows total current assets amounting to \$194,268 and total current liabilities of \$143,303; and also shows total assets of \$850,225, including \$238,872 for going-concern value. The liability side shows capital stock of \$250,000, and capital surplus \$685,879, less a debit balance as of January 1, 1938, of \$181,270, and operating loss for 3 months ended March 31, 1938, of \$50,577, leaving a net capital surplus of \$454,032.

As previously stated, it is planned to conduct the operations over this new route with only a small increase in equipment, and the increase mileage should, of course, result in reduction of per mile costs for items other than those embraced in direct flying costs.

Upon this submission we perceive no objection to the acceptance of the bid by the Postmaster General.

By the Commission, division 3.

W. P. BARTEL,
Secretary.

(SEAL)